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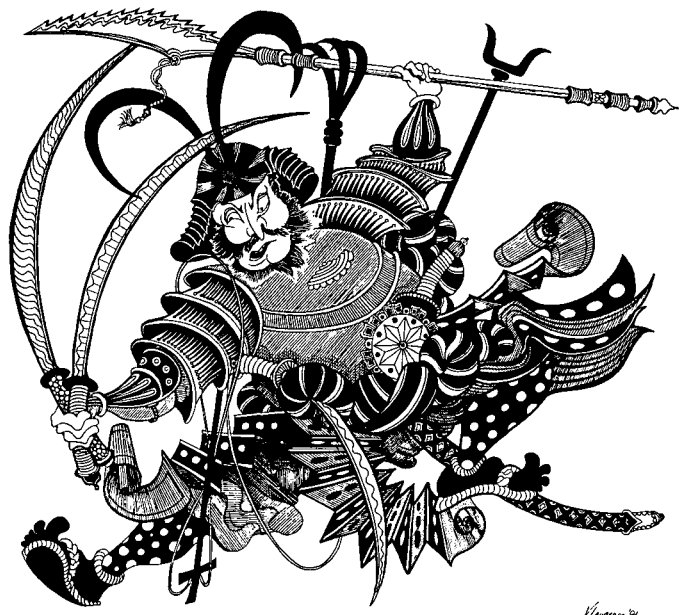
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There's No Such Thing as Free Trade



■ Who's a reader to believe? In the spring issue, Pietro Nivola ("More Like Them?") offers the standard bromides about Japanese and American industrial policy: Japan's industrial policy isn't always effective, while our piecemeal version of industrial policy is about as effective as it could be. His unsurprising conclusion: there's no reason for us to be concerned either way. But in the very next article, Kenneth Flamm ("Making New Rules") tells us that Japan's industrial policy for semiconductors has been so successful—and poses such a significant danger to the United States—that we must either convince them to stop, or else abandon free trade altogether and insist that they purchase a fixed portion of their semiconductors from us.

Both authors can claim a bit of the truth, but neither of their conclusions bears upon the central issue, which has nothing whatever to do with whether industrial policy (theirs or ours) is good or bad. Nor does it turn on theological

cal disputes over the wisdom of government intervention versus free markets and free trade. All governments intervene. "Free markets" and "free trade" exist only in the eyes of the beholder. The issue is how best to coordinate national industrial policies so as to avoid "zero-sum" or "negative-sum" games of a sort that are likely to inhibit or reduce global wealth, while promoting "positive-sum" games that are likely to enhance global wealth.

Accordingly, government-sponsored R&D should be tolerated, even encouraged. The same for loan guarantees, tax breaks, and other subsidies targeted to industries or technologies likely to have significant positive spillovers. Ditto for public investments in education, training, and infrastructure.

But there should be rules that define and discourage predatory industrial policies, by which one nation strategically undermines the capacities of another nation to undertake certain forms of production.

There's also a need for international agreement about when, how, and under what circumstances governments can lure global direct investment to their shores. And governments should decide together what sorts of nontariff barriers are most likely to reduce global welfare rather than to enhance it (for example, while there may be some justification for protecting infant industries, as Alexander Hamilton noted two centuries ago, and as the U.S. Federal Communications Commission apparently assumed several months ago when it decided against Japan's proposed standard for high-definition television, there's little justification for "buy American" provisions in most U.S. government procurement regulations).

Sorting out "positive-sum" industrial policies from "negative-sum" industrial policies won't be easy, and getting governments to agree to such sortings will be a Herculean task. But such an exercise, and aspiration, is bound to be more fruitful than one that views all industrial policies as either misguided or dangerously effective.

Robert B. Reich, Harvard University

Open Clinical Drug Trials

■ In "The Fast Track" (spring issue) Christopher Foreman discusses the challenge by AIDS activists to "traditional criteria" for conducting randomized controlled clinical drug trials (RCTs). He concludes that "AIDS advocates have effectively challenged the establishment . . . through an insurgent movement toward 'community-based' research that makes treatment available to as many people as possible."

Leading trialists in the

United Kingdom, notably Richard Peto, have for years condemned the "traditional criteria" used for RCTs in the United States as expensive and leading to inferior results. Before the insurgency Foreman describes, however, these criticisms were more often repelled as dangerous than refuted under the rules of science. Outside of AIDS research, there remains considerable resistance to broadening the criteria for who can be admitted to a trial, enlarging trials to admit patients in many different settings, and reducing the expensive scrutiny of each enrollee throughout the trial.

The AIDS insurgency, that is, has opened the politics of science to what many experts claim to be better methodology. Here is yet another example of the old point that democracy can often be a useful way to do politics as well as a splendid theory.

Daniel M. Fox, President, Milbank Memorial Fund

Will Black Vets Find Jobs When They Get Home?

■ Ed Dorn ("The Home Front," spring issue) argues that the 400,000-plus black men and women on active duty are not "economic conscripts"; rather, he claims, they are "volunteers" who have made an "economically rational" choice to join the military. Dorn is playing with words and obliterating the obvious. Indeed, his facts seem to contradict his conclusions.

He notes, for example, that black high school graduates are far more likely to enlist in the military than are equally well-educated whites. There are only two possible explanations: either blacks are more patriotic than whites, or their options are more limited. Any reasonable person would in-

cline toward the latter view.

In recent testimony before the House Armed Services Committee, I cited studies that suggest that the employment options available to blacks are considerably narrower than those available to whites. And, once employed, young whites are far more likely than young blacks to get on-the-job training needed for upward mobility. And only 27 percent of black high school graduates go on to college, while 40 percent of their white peers do so. Although not compelled to join the military, blacks clearly are under relatively more compulsion than whites.

Dorn celebrates the military's progress in equal opportunity, but the military is a winner in a very slow race. It is not that the military has behaved nobly toward black Americans, but that the private sector has behaved abominably.

Over the next few months tens of thousands of young black men and women, many of them Persian Gulf veterans, will be leaving the military and seeking jobs in the civilian sector. Are there training programs to help them make the transition; are there decent jobs to be had; and will their civil rights be protected?

Ronald Walters, Howard University

What Needs Reforming?

■ In the spring issue, Gary Burtless ("The Tattered Safety Net") called for reform of the unemployment insurance program. For a number of reasons, Mr. Burtless's analysis is off base.

Burtless's call for changes in the basic (regular) program is based on the assumption that it is somehow "broken." It is not broken, and in fact is paying out over half a billion dollars a week to almost 4 million people. This fiscal year, the

program is expected to pay \$25.2 billion to 10.7 million unemployed workers—almost double the payments from the cyclical low in fiscal year 1988.

During the first calendar quarter of 1991, the state regular program weeks claimed as percent of total unemployment—the so-called "gap"—averaged 46 percent. The number for March was 47 percent. With 58.6 percent of the unemployed represented by job losers, this implies that 80 percent of UI's potential claimant base is being served. This figure is larger than the comparable figure during the 1981–82 recession; the gap has closed and is smaller than it was during 1981–82.

The extended benefit program is also operating effectively and is not in need of revision. The United States is experiencing a mild recession, and the flow of unemployed workers into and out of the UI program reflects that situation. The rate of jobless workers exhausting benefits from the regular program currently stands at 30.4 percent (February 1991), about equal to the early 1988 levels, and nowhere near the almost 41 percent rate of the last recession. The extended benefit program has triggered on in nine states where unemployment levels have become high. This number is smaller than in past recessions; it reflects the lower number of claimants expected during this shallow recession, which serves to reduce the need for benefits extension.

Burtless also wants to make long-term changes in the UI program that would impose federal standards on the benefit side of the program and change the tax side of the program. He ignores the half-century history of a program established and maintained as a partnership between the states and the federal govern-

ment. Federal legislation has always provided that the states will determine the benefit and tax provisions of the UI program. The states tailor the UI program to reflect the need of their own communities, while adhering to the broad requirements set by federal law. In the case of eligibility and benefit criteria, each state legislature determines and reviews its own state provisions. It is the administration's position that there should be no federal intrusions into areas such as these that are—and should most appropriately remain—the responsibility of state governments.

Both the regular and extended benefit programs are accomplishing their goal of providing temporary, partial income protection to workers who have lost their jobs through no fault of their own. Burtless proposes to change the mandate of the program from that of a federal-state unemployment insurance program to a federalized long-term income maintenance program. The administration believes that the mandate given the UI program in 1935 should be retained and that the federal-state partnership and insurance nature of the program are still fundamental and appropriate for the program in the 1990s.

Mary Ann Wyrsh, Director, Unemployment Insurance Service, Department of Labor

A Judicial Pat on the Back

■ I would like to add a few words to Robert Katzmann's "Building Bridges" (spring issue). Since 1987 I have served as Chairman of the Budget Committee of the Judicial Conference of the United States. The committee's job is to present to Congress the budget request for the federal courts. The process, which involves con-

tinuous communication between the judicial and legislative branches, has taught me a few things.

First, the members of our appropriations subcommittees are both solicitous and knowledgeable about the administration of justice. They work under severe fiscal restraints. The courts' budget is categorized for congressional budgetary purposes as "domestic discretionary spending." Recent budget agreements have placed severe, almost inflexible, limits on such spending. An increase for the courts, therefore, necessarily means less money for some other domestic purpose. But our budget increases over the past few years compare quite favorably with those of other domestic "agencies."

Second, members of Congress tend to know, and necessarily so, considerably less about the fine print than does the subcommittee staff. The staff members with whom I have worked are sympathetic to the courts' needs, knowledgeable about our operations, and properly inquisitive as to opportunities to save the taxpayers' money. We don't get everything we ask for, but we do get, most of the time, what we really need—a result due in large part to the interest and knowledge of the staff.

Finally, although the temptation must be there from time to time, in my experience no member of Congress or staff person has ever suggested during these annual budget discussions that the courts' appropriation might depend upon particular outcomes of court cases.

Richard S. Arnold, U.S. Court of Appeals, Eighth Circuit

The Review welcomes comments from its readers. Letters will be edited to conform to style and space.

This Time the Military Got It Right

BY LAWRENCE J. KORB

Despite the continuing turmoil in the Middle East, there is no doubt that the United States-led coalition achieved its military objectives rapidly and overwhelmingly in the Persian Gulf; that is, the American-led forces liberated Kuwait and destroyed the ability of Iraq to threaten its Middle Eastern neighbors militarily.

The superb performance of the American military men and women and weapons on the battlefield surprised those who remembered the problems that our military had in Vietnam, Desert One, Lebanon, and Grenada. But the Persian Gulf War was fought under circumstances that set it firmly apart from those other operations. There were essentially four reasons the military was much more successful this time.

The first reason was the unity that existed at all levels of command. The Goldwater-Nichols Defense Reorganization Act of 1986, passed over the vehement objections of the Secretary of Defense and the Joint Chiefs of Staff (JCS), gave the Chairman of the Joint Chiefs, Colin Powell, and the field commander, General Schwarzkopf, the power they needed to run the operation. Powell did not need to get the consensus of the other four members of the JCS either on the advice he provided to President Bush or on the approval he gave to Schwarzkopf's battle plans. Schwarzkopf, in turn, had the power to control all of the forces assigned to the Gulf without interference from the service chiefs in Washington. In Vietnam, General Westmoreland ran only the ground war in South Vietnam while the air campaign against North Vietnam was run by a Navy admiral in Hawaii. Westmoreland could not even order Marine aviation units stationed in South Vietnam to support Army ground troops without

getting all five members of the JCS in Washington to vote on the issue. Similarly, the attempt to rescue the American hostages in Teheran failed in part because it was run by a committee; and to this day, no military officer has assumed responsibility for the order to the Marine sentries protecting the barracks in Lebanon not to load their guns. Finally, the invasion of Grenada floundered because of poor coordination among the services.

Second, the Gulf War was waged by a professional military. The average military person in the Gulf was a volunteer with about seven years of service and two full years of training. Moreover, most of the people had been members of their units for approximately two years. The Vietnamese War was fought primarily by young conscripts who were a product of a grossly unfair draft, had received but a few months of training, and were sent over to Southeast Asia as individuals to join a unit of strangers. Moreover, the young men and women sent to the Gulf had several months to practice their missions.

Third, the United States had time to deploy its vast logistic support system. In the five and one half months that elapsed between the Iraqi invasion and the initiation of hostilities, the United States moved more than 500,000 people and 3 million tons of equipment several thousand miles to the Gulf. Included in this shipment were thousands of technical representatives from defense companies and vast stores of spare and repair parts for the equipment. While the United States deployed about 30 percent of its planes, ships, and tanks to the Gulf, it had nearly 60 percent to 70 percent of its maintenance capability in the area. For example, the Pentagon sent 275 of its 640 Apache helicopters to



the Gulf, but shipped so many of the helicopter's spare and repair parts to the region that the 365 Apaches not in Saudi Arabia could fly only four minutes a day. Moreover, the Army sent 280 civilian technicians from defense companies to the Gulf to keep the Apaches in good working order. The 1980 attempt to rescue the hostages in Iran was aborted at Desert One because mechanical problems en route to the staging area grounded three of the eight helicopters.

Fourth, the Persian Gulf "battlefield" was tailor-made for American weapons and tactics. Unlike Vietnam, the Gulf offered neither dense jungles and villages in which the enemy could hide nor neighboring countries in which the enemy could take sanctuary and then return to the fray. The wide-open desert landscape, coupled with our unlimited ability to gather technical intelligence, allowed superior American firepower to locate

and destroy the Iraqi forces and break their will to fight. Similarly, by digging in along the Kuwaiti border, the Iraqi forces all but invited the U.S. ground forces to employ the maneuver tactics they had developed to fight the Soviets in Europe.

While the American military should take pride in its victory, it cannot afford complacency. Rarely, if ever, will it encounter the same set of circumstances that existed in the Persian Gulf. Just as it built on the failures of the past two decades to achieve success in the Gulf, it needs to learn from its victory over Iraq. ■

Lawrence J. Korb is director of the Brookings Center for Public Policy Education. He is the coauthor, with William W. Kaufmann, of The 1990 Defense Budget (Brookings, 1989).



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THE NEW FACE OF THE AMERICAN MILITARY



The Volunteer Force and the Persian Gulf War

In the wake of the stunning victory of the U.S.-led military coalition over the forces of Saddam Hussein, attention has turned toward the lessons to be drawn from that conflict. The inevitable postwar assessments of military strategy, doctrine, tactics, and weapons have been initiated by media pundits, Congress, the General Accounting Office, various think tanks, and the services themselves. Largely ignored, but no less important, are the lessons that Operations Desert Shield and Desert Storm hold for defense manpower policies and especially for America's all-volunteer force.

The decision to replace the draft with a volunteer system in 1973 was controversial at the time, and the potential combat effectiveness of the volunteer force has remained a bone of contention ever since. Both skeptics and champions of the volunteer concept will look to the battlefield experience of the Persian Gulf War to help settle the question of whether a volunteer force is more or less effective than a conscript force under wartime conditions.

While the abbreviated conflict was something less than a litmus test, the men and women volunteers of the U.S. armed services, according to all preliminary reports, passed with flying colors. Supporters emphasize that today's armed force is, after all, the best in the nation's history. Compared with their draft-era predecessors, for example, today's volunteers are better educated, more technically literate, more easily trained, more motivated, and less likely to abuse alcohol or to present other disciplinary problems.

Yet several aspects of the nation's armed forces,

MARTIN
BINKIN

Martin Binkin, a senior fellow in the Brookings Foreign Policy Studies program, has written extensively on defense manpower issues. He is at work on a forthcoming book, Rethinking the All-Volunteer Force: Lessons of the Persian Gulf War.

which have been by-products of the decision to adopt a volunteer system and have enjoyed wide acceptance in peacetime, appeared to unsettle the American public in wartime. The Persian Gulf conflict ended before the concerns matured into full-blown problems, and policymakers may prefer to turn their attention elsewhere. But failing to address those concerns now invites their return in the future, with potentially serious military and social consequences.

Today's Fighting Force Has a Different Look

The conversion from a conscripted to an all-volunteer force dramatically changed the makeup of the American military. Once peopled mostly by young, unmarried, white males, today's armed forces are composed of unprecedented proportions of minorities, women, married couples, and single parents and are dependent more than ever before on part-time reservists.

These changes resulted in large part from economic realities to which the armed forces have had to adapt since the end of the draft. Military pay—especially for entry-level recruits—was increased substantially to ease the transition to a volunteer system, but the armed forces soon realized that competing for qualified volunteers in the marketplace was a tall order, prompting them to look beyond their traditional target population.

Recognizing that an active force of just over two million was the most that the nation could expect to field without incurring prohibitive costs or compromising quality standards, Congress and Pentagon leaders assigned greater responsibilities to the reserve components. Meanwhile, minority representation in the volunteer force grew sharply as blacks exhibited a

much stronger propensity than white youth for military service. The proportion of women enlistees also increased substantially as the armed forces, facing not only recruitment problems but also pressures from the feminist movement, opened more positions to women. Finally, increases in the value of dependent-related benefits encouraged an increase in the number of married military personnel and in the average size of their families.

While most Americans thought little about, much less questioned, these changes in the character of the American military establishment, several interest groups greeted them with enthusiasm.

Peacetime Benefits

The sizable contingent of reserve devotees in Congress, for instance, was pleased that the citizen-soldier concept, which had been badly tarnished during the Vietnam era, experienced a renaissance of sorts as reserve units were assigned broader responsibilities in national security planning. Many feminists, too, were delighted that women were finally accepted by one of the most formidable male bastions in American society, while some looked forward to removing the last remaining barrier: combat duty. Some social commentators were equally gratified to see that minorities with relatively bleak civilian employment alternatives were able to enjoy the economic and social benefits of peacetime military service. And the sharp increase in the number of married personnel and their dependents was greeted by some as a sign of a more mature, experienced, and stable work force, better able to operate and maintain increasingly sophisticated military systems.

Unanswered Questions

Other commentators, meanwhile, were attempting to alert the public that each of these trends might have a downside as well. The overarching purpose of the armed forces, after all, is to protect the national security, and there were reasons to question the extent to which the changes that accompanied the adoption of voluntary recruitment might impose political and social constraints on the conduct of military operations under wartime conditions.

The unprecedented wider and earlier reliance on reserve forces, for example, seemed to be based as much on domestic and bureaucratic politics as on military considerations. Some analysts raised serious questions, based on historical experience, whether part-time citizen soldiers could maintain necessary levels of combat readiness. The greater opportunities for women represented a huge success in equal opportunity but left hanging the question of how they would perform in wartime. A growing family orientation gave the military a gentler image but left some to wonder how parents would cope with the simultaneous and often conflicting commitments imposed by two of the most demanding institutions in our society. Finally, whatever benefits were derived by blacks in the peacetime military, it was urged, needed to be weighed against the prospect that they would suffer disproportionate casualties in wartime.

These warnings went largely ignored as the armed

forces were successfully filling their ranks with qualified volunteers. Except for the brief military operations in Grenada and Panama, the volunteer force had not been to war, and there seemed to be little prospect that a conflict was in the offing, especially following the disintegration of the Warsaw Pact. In a peacetime environment, it seemed churlish to find fault with changes in the armed services that were merely keeping pace with and absorbing changes taking place in American society as a whole. And there appeared little reason to argue, in the case of the unprecedented reliance on military reservists, that the citizen-soldier concept should not be rejuvenated.

Then, suddenly, last August Iraq invaded and occupied Kuwait, and the nation's volunteer force confronted its first real test. It was not long before questions were being raised about the composition of American forces deployed to the Persian Gulf.

Are Black Soldiers Economic Conscripts?

Of all troops sent to the Gulf during Operations Desert Shield and Desert Storm, about 25 percent were black, roughly twice their representation in the population. The prospect that blacks would be likely to sustain one-fourth of the combat casualties, which many predicted would be substantial, aroused the concern of many black leaders, most of whom opposed U.S. military intervention in the Persian Gulf from the outset. The issue of "economic conscription" was raised by those who lamented the fact that, while young blacks might not have been drafted in the strict sense of the word, they had been compelled by lack of other opportunities in American society to turn to a hazardous occupation. Many in the current black leadership found the situation especially ironic, juxtaposing the prospect of disproportionate casualties with President Bush's October 22 veto of the Civil Rights Bill of 1990 and the administration's suggestion that college and university scholarships earmarked for blacks were discriminatory.

Other blacks, however, hailed the military as one of the least racially discriminating institutions in American society and a role model for affirmative action. Taking issue with the critics, General Colin Powell, the first black to lead the nation's armed forces, expressed his pride in the composition of the forces and pointed to the opportunities for upward mobility that the military services provided to young African Americans.

Black Overrepresentation: A 20-Year Trend

The issue of disproportionate black representation in the armed forces, treated by the news media as a recent phenomenon, commanded wide public attention. In fact, the overrepresentation of blacks in the military did not sneak up on the nation, but was part of an upward trend that can be traced to the end of the draft, as shown in figure 1. In 1973 blacks made up 12 percent of the military; today they are about 20 percent of the total. The most dramatic change has taken place in the Army enlisted ranks, where the proportion of blacks has grown from about 18 percent to just over 32 percent. The considerable gap between the propensities of black and white youths toward military

service was especially evident during the latter half of the 1970s, when at least 42 percent of all black youth who were potentially eligible for military service actually enlisted, compared with less than 14 percent for whites. Moreover, once in the service, blacks traditionally have been far more likely than their white peers to make the military a career.

These trends elicited little public reaction as they were taking shape through the 1970s. The nation at large, according to a survey taken in the early 1980s, was not "concerned" that blacks were overrepresented in the military; indeed, 70 percent of respondents felt that the proportion at that time was about "right." Among black leaders, the few who criticized the inequities of the situation were outnumbered by those who applauded the military as a model for equal opportunity. But most remained silent. The seeming ambivalence underscored the quandary posed by the issue, a dilemma shaped by perceptions of equity, which are greatly influenced by the perceived ratio of benefits to burdens in military service. When the benefits are seen to outweigh the burdens, as they are in peacetime, many believe that the overrepresentation of racial minorities can contribute to true social equity. When the burdens of enlistment are seen to outweigh the benefits, however, attention is focused on social and racial class distinctions, and any overrepresentation of disadvantaged minority groups is perceived as evidence of systemic inequity.

Low Casualties This Time. Next Time?

It should not have come as any surprise, then, that the issue was raised during the Persian Gulf crisis, as it is bound to be in any future military conflict. This time, the nation was fortunate. The gloomy casualty predictions did not materialize. Twenty-seven black soldiers were killed during the Persian Gulf conflict, or about 15 percent of total deaths. It is safe to speculate, however, that had the casualties mounted, so too would the proportion of blacks among them, as would the decibel level of criticism by black leaders.

The key question raised by this experience is what the nation can do to hedge against the divisive effects of disproportionate black casualties in future military conflicts. As matters stand, there are few alternatives for creating a military force that closely resembles American society, and probably none that would be socially or politically acceptable.

The approach most often suggested, as it was by some critics during the recent conflict, would be to return to the draft. But to make any but a minimal change in the racial composition would require that qualified young blacks either be *denied* the opportunity to volunteer (say, by raising entry standards) or be *discouraged* from enlisting (say, by lowering military pay) to make room for white draftees. It would also be possible, but impractical, to field a more representative force by enlarging the armed forces until the number of draftees representative of the youth population swamped the number of black volunteers.

The inescapable conclusion, then, is that the United States will have to live with a racially unrepresentative force until it can resolve the many com-

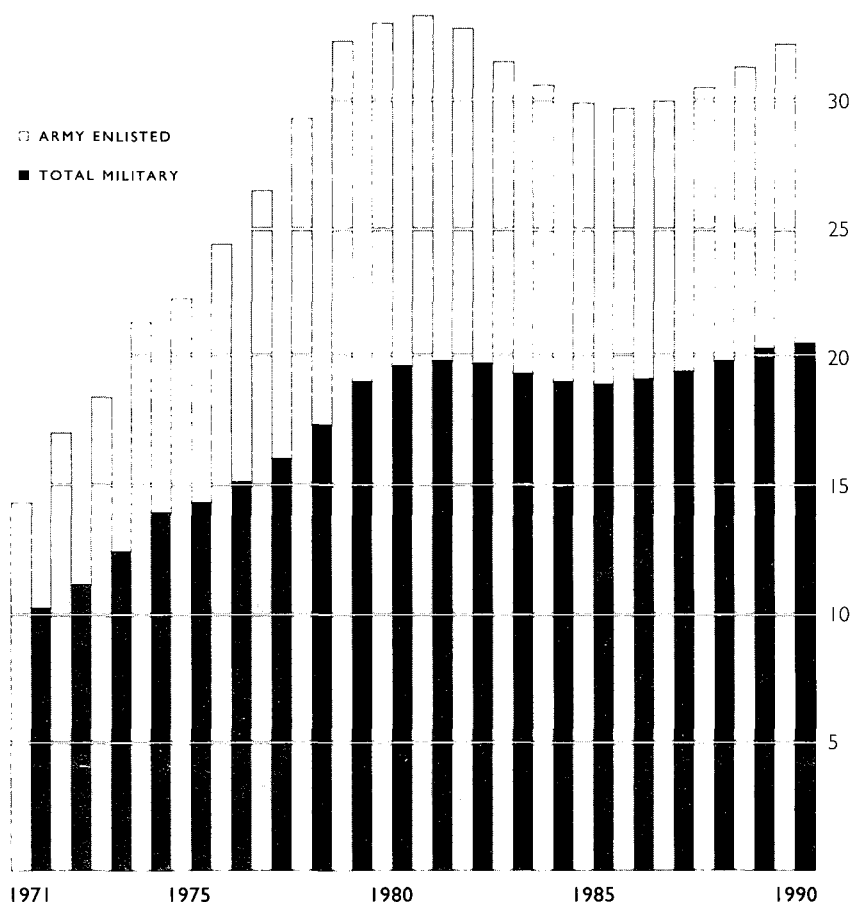
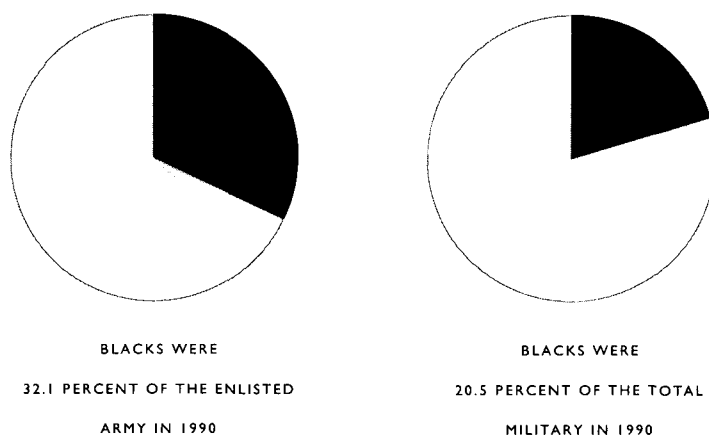
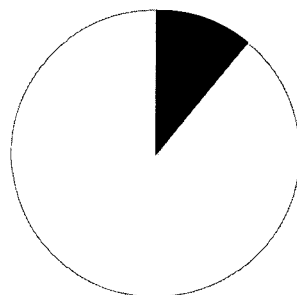


Figure 1. Blacks in the Military, 1971-90

PERCENT OF TOTAL

Source: Department of Defense



WOMEN WERE
10.9 PERCENT OF THE TOTAL
MILITARY IN 1990

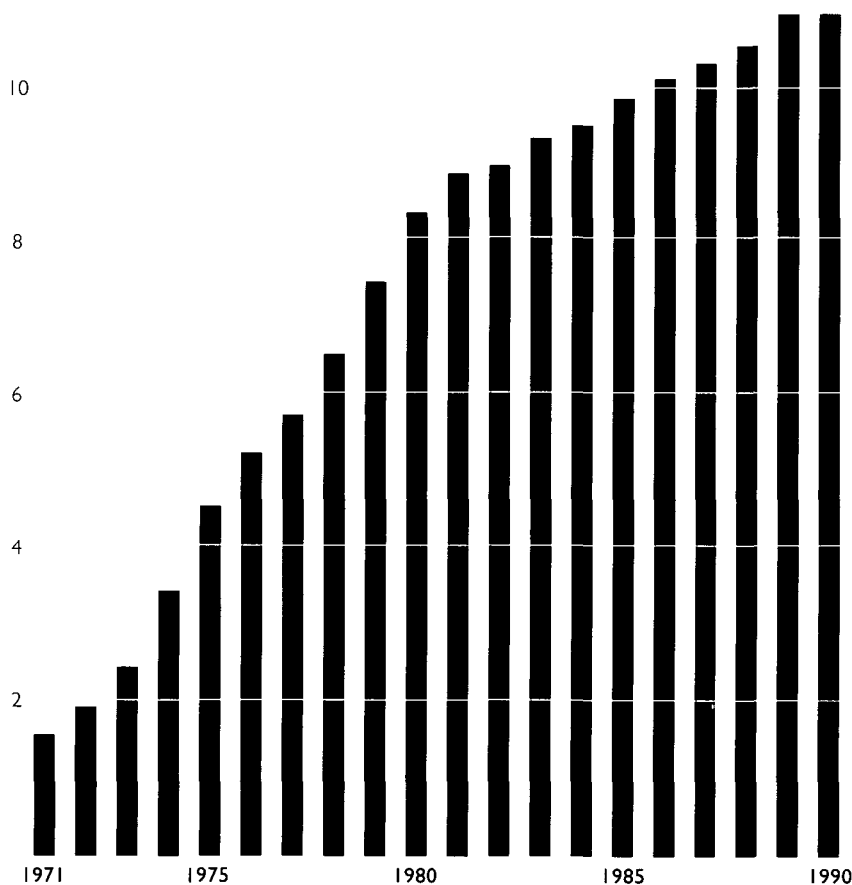


Figure 2. Women in the Military, 1971–90

PERCENT OF TOTAL

Source: Department of Defense

plex problems that contribute to the greater propensities among blacks for military service. Against that prospect, the best that can be expected is that the nation's new understanding of the disproportionate role of blacks in the armed forces and their potentially greater sacrifices in future conflicts will provide an impetus to create better employment opportunities for black citizens in the nonmilitary sector. Meanwhile, it can be hoped, a greater public awareness of the issue will blunt the racially divisive rhetoric that could polarize the nation at a critical juncture in the future.

Women and War

One of the most publicized aspects of the all-volunteer force has been the growing number of women filling its ranks. In 1973, as figure 2 shows, some 55,000 women composed just over 2 percent of the military population. Today more than 225,000 women make up close to 11 percent of the total. Also, since 1973 the proportion of women assigned to jobs outside of their traditional medical and administrative roles has grown from fewer than 10 percent to more than 50 percent.

The transition, however, has been anything but smooth. The armed services, traditionally one of the most male-dominated institutions in American society, has had great difficulty adapting to the wider role of women. Rancorous debates accompanied the entrance of women into military academies, and controversies still surface from time to time, as in the case of sexual harassment charges that have plagued the military in recent years. Equally bitter arguments have continued to surround the question of women in combat. The services have progressively opened more and more combat-related positions to women, but women are still precluded by law from serving on "combat" aircraft or ships and by Army policy from serving in infantry and armored units and in "noncombat" units for which the risks of exposure to direct combat, hostile fire, or capture by the enemy are deemed too great.

Proponents of assigning women to combat duties have argued that such constraints have prevented women from filling mainstream assignments in the armed forces, thereby limiting their opportunities for advancement. Opponents of further relaxing combat limitations have argued from several points of view: the American public is not prepared to see women casualties or prisoners of war; women do not possess the physical attributes for combat duty; they are not emotionally suited for the arduous and grisly business of combat; and women would disrupt the male-bonding considered essential to the performance of combat units.

Another Catch-22

The questions have remained unsettled partly because the burden of proof is on those who support combat roles for women to demonstrate that unit effectiveness would not be diminished—something that is difficult to do without assigning women to combat. Thus the performance of more than 33,000 women sent to the Persian Gulf to fill a wide variety of nontraditional jobs, many under austere and hazardous conditions,

was watched closely, as was the reaction of their male counterparts. By virtually all accounts, the women serving in the Gulf proved their mettle—and by extension the mettle of all future female soldiers. Thirteen women died, including five that were considered combat fatalities, and two more were taken prisoner.

While the conflict was too limited and the casualties too few to provide confident assessments, several general observations seem warranted. First, against many predictions that Americans were not prepared to accept female casualties and especially women POWs, the public did not appear to react any differently than it did to male casualties and POWs. Second, the participation by women in military operations so near to the “front lines,” especially the parts played by a woman helicopter pilot in an air assault operation deep into Iraq and by a woman doctor captured during a behind-the-lines search and rescue mission, blurred further the distinctions between combat and support duties. Finally, the deaths of female Army reservists during a Scud attack on Dhahran can be expected to strengthen the arguments of those who have contended that, given the nature of modern warfare, the concept of the traditional “front” has become an anachronism and the differences in risks associated with combat and support jobs have narrowed.

On balance, the conflict did much to earn for women the respect of their male peers that had proven so elusive under peacetime conditions and is likely to buttress the case for removing all remaining occupational barriers for women in the military. A *New York Times*-CBS poll taken in January 1990 found that seven of ten Americans thought women should be allowed to fill combat jobs. A committee that advises the Secretary of Defense on women’s matters has already called for the repeal of laws barring women from combat roles. The House Armed Services Committee voted to allow women to fly combat aircraft. But many advocates of the removal of combat barriers still appear ambivalent about opening some ground combat jobs, especially in infantry and armor units.

One issue that is yet to receive a full airing and needs to be addressed before all combat restrictions are lifted is whether women—like their male counterparts—would be assigned *involuntarily* to combat duties in the event of full mobilization requiring a return to the draft. This, in turn, would be certain to reopen the thorny question of draft registration, for which women are now exempt.

The Family and the Military

Countering women’s gains, however, was widespread concern about the deployment of mothers to a combat theater. The nation’s acceptance of women as soldiers, it seems, stops somewhere short of the acceptance of mothers as soldiers. Several influential members of Congress, disturbed by the notion that infants and young children were being left in the care of others, admonished the Pentagon to change its policy so as to preclude the deployment of mothers to a war zone.

The issue of children being left behind by their mothers was soon broadened, however, with the realization that children were suffering the same fate

with the deployment of single parents, including large numbers of men, and of married couples, both members of which were in the armed forces. The issue was far from trivial. There are some 67,000 single parents in the military, including about 40,000 men, and an additional 46,000 “dual service parents”—so called because both father and mother are in the military active or reserve components.

These numbers are part of an overall trend in the armed forces that, like the growth of minority and female participation, accompanied the adoption of the all-volunteer force. The contemporary military is much more family oriented than its draft-era predecessor, with close to 52 percent of its enlisted members married, up about 30 percent over 1971. Over the same period, the average per capita number of dependents for the enlisted force grew about 40 percent, from 1.12 to 1.58.

One reason for these changes was the military’s need to expand its recruitment beyond its traditional target population of young single men to allow it to compete successfully in the marketplace. Another was the military compensation system, whose benefits—in particular, larger housing allowances and access to virtually free medical care—are relatively more attractive to enlistees with dependents than to those without. Finally, in the late 1970s the armed forces began to pay travel expenses for dependents of junior enlisted personnel, which made military service an even more attractive employment option for those who were married.

Both the resultant growth in dependent-related costs and the inevitable problems associated with the assignment and deployment of single parents and dual-service couples were acknowledged by the armed services, but were accepted as normal costs of doing business in an all-volunteer environment. Although military sociologists were pointing out the potential conflicts between the military and the family, the armed forces appeared to be working their way through the problems, at least until the all-volunteer force went to war.

Who’ll Take Care of the Kids?

With the deployment of American forces to the Persian Gulf, the nation as a whole suddenly noticed that mothers, single parents, and, in some cases, *both* mothers and fathers were being sent to a combat theater. Social commentators reacted quickly upon learning that an estimated 20,000 single parents and 2,200 dual-service parents had been sent to the Gulf. On February 10 the *Washington Post* featured an article by Sally Quinn entitled “Mothers at War: What Are We Doing to Our Kids?” in which she implored President Bush to “bring our mothers home.” Two days later the same paper carried Ellen Goodman’s “Work, Family, and the Military,” recounting “a reservist and mother being called to duty and pleading for enough time to wean her baby.”

The issue posed an obvious dilemma for many feminists caught in a tug of war between equal opportunity for women, on the one hand, and concern for infants and children left behind, on the other. The

general public also seemed uncomfortable with the situation, as reflected by an Associated Press poll published on February 21 showing that two of every three Americans felt that sending women with young children to a war zone was unacceptable. Finally, the dual-service parent issue was highlighted in *Time* magazine's February 18 issue, in an article entitled "When Mom and Dad Go to War."

As concerned legislators became aware of the scope of the issue, some urged the Pentagon to exempt military parents from assignment to the Persian Gulf. Congresswoman Barbara Boxer (D-Calif.) proposed "the military orphans prevention bill" to allow single parents and members of the armed forces who have a spouse assigned to a combat theater to seek waivers from assignment to a combat zone. Congresswoman Beverly B. Byron (D-Md.), a key member of Congress on military personnel issues, also sought changes in the military's assignment process.

Pentagon leaders resisted changes, arguing that the parents involved were volunteers fully aware of their potential wartime deployment and the need to make child-care arrangements. They also contended that such exemptions would create substantial administrative problems and, in some cases, would degrade the combat readiness of military units. Many women in the military, too, opposed the idea, fearing that any special exemptions for parents would set back their hard-won gains for equal treatment. The Pentagon did set about to standardize varying individual service policies, but the quick end to the conflict brought a quick end to the controversy.

The military and social implications of this thorny issue are too important to allow it to be shelved. Policymakers must resolve it before the nation commits its armed forces again. Several options are available. One possibility is tinkering with deployment rules for parents, such as exempting mothers with infants under six months of age. More drastic reforms would include discharging single parents from the military services and, as suggested by General Alfred Gray, Commandant of the Marine Corps, prohibiting military service by both husband and wife when a couple has children. Indeed, it may be time to reconsider whether it is in the nation's best interest for the military to subsidize marriage.

The "Total Force" Goes to War

The Gulf War also provided the first test of the so-called total force, the policy adopted in the early 1970s under which the reserve components had been assigned wider and, especially, *earlier*, responsibilities for the nation's security. In a break with the past, when reserve forces were literally "held in reserve" with a cushion of time to complete mobilization and training, the new total force planning required many reservists to deploy along with the active forces, some with only a few days' notice and most of the remainder within weeks rather than the customary months or years. To facilitate this plan, in 1976 Congress granted presidential authority to call up a limited number of reservists for a limited period of time *without* requiring a declaration of a national emergency.

According to Army contingency plans, for example, reserve units were to be among the earliest deployed in a range of conflicts—from fast-breaking limited contingencies to a major confrontation in Central Europe between NATO and the Warsaw Pact. Reservists were to make up more than 40 percent of the Army forces deployed during the first 30 days of a European war, and a sizable number of reserve combat and support units were earmarked for the rapid deployment mission. Under this new planning concept, few ground campaigns could be conducted without involving the reserve forces almost from the very beginning.

The total force policy has been controversial since its inception. Its supporters argued that it was a cost-effective way to maintain force structure in the absence of the draft, that it would nurture the revered "citizen-soldier" concept, and that the prospect of having to mobilize the reserves for any but the smallest contingencies would deter presidents from getting involved in conflicts, such as Vietnam, that did not have wide popular support.

Critics of the policy, on the other hand, were concerned that the unprecedented degree of reliance on the reserves had gone too far, that it was unreasonable to expect units, especially Army reserve combat brigades, to maintain active-duty readiness standards within the limited training time available to them, and that making it easier for a president to mobilize the reserves did not make it easier to take the decision to do so. Moreover, they argued, the traditional rivalries between active and reserve components that have marred every mobilization since World War II still existed and would present an obstacle to any future call up, despite the "one-big-happy-family" rhetoric of the total force.

The President Calls Up the Reserves

Operation Desert Shield presented the first opportunity to settle the debate. Barely two weeks into the operation, President Bush called up 48,000 reservists. The Air Force and Marine Corps activated some combat units, while the Army restricted its initial call to support units, such as medical, transportation, military police, and the like. Conspicuously absent from the mobilization roster were two high-priority Army National Guard brigades that, under all the pronouncements of the total force policy and by most understandings of the Pentagon contingency plans, would have accompanied the first two active Army mechanized divisions dispatched to Saudi Arabia. In their places, the Army assigned active Army brigades to fill out the deployed divisions. The Army explained that it did not send the National Guard brigades because the decision to deploy one of the mechanized divisions was made two weeks before the decision to mobilize the reserves and that 180 days—the maximum available under the mobilization authority—was insufficient to employ them effectively.

This decision, however, was criticized strongly by reserve advocates, especially those in Congress who had been ardent supporters of the round-out concept and who had been largely responsible for diverting

limited resources—including factory-fresh M1 tanks—to the National Guard brigades. Under heavy pressure from Congress, the Pentagon finally called up three reserve combat brigades, with the proviso that a decision regarding their combat deployment would be made only after a period of post-mobilization training. The subsequent training period was marked by reports critical of the brigades' lack of preparedness, the poor quality of their leadership, and their lack of military discipline.

Eventually, one of the brigades was certified as combat ready, but the Gulf conflict ended before a decision had to be made concerning deployment. Shortly thereafter, all three round-out brigades were deactivated.

Several lessons can be drawn from this episode. The first and most obvious is that round-out brigades should not be assigned missions that would require their early deployment. These units, under the best of circumstances, require a period of post-mobilization training of at least several months and, more likely, six to nine months. Accordingly, the Army should consider rounding out with units smaller than brigades, such as battalions or companies, which could maintain higher levels of peacetime readiness and would require less training after mobilization. Finally, the success of the round-out concept at any level will require more cooperation between active and reserve components and a greater respect than now exists among active officers for their reserve counterparts. This in turn will require that reserve officers be held to the same standards as active officers, a difficult bureaucratic nut to crack, especially where the National Guard with its dual federal-state status is concerned.

Unfortunately the combat brigade issue captured most of the media attention and masked the two most notable successes of the total force policy. First, the quick call up of the reserves dispelled the skepticism that, because of domestic political considerations, a president would be reticent to use them. By involving small-town America to such a large extent, the decision to use citizen soldiers arguably contributed to the strong public support sustained throughout the conflict. Second, the mobilization and deployment of well over 200,000 reservists was conducted with a minimum of administrative or logistical problems and without the widespread complaints and bitterness expressed by reservists in previous activations. On balance, the total force served the nation well during the Persian Gulf conflict, and the problems encountered with the round-out brigades, while serious, should not dominate assessments of the overall concept.

Now Is No Time to Hope for the Best

In the flush of America's lightning victory in the Persian Gulf, it is tempting to conclude that every element of the nation's armed forces performed flawlessly—strategy, doctrine, tactics, weapons, and, above all, the men and women composing the all-volunteer force. With time, foul-ups and problems are certain to be identified, but up to this point, it is difficult to find fault with any aspect of the U.S. military's performance, save the few instances of friendly fire and of

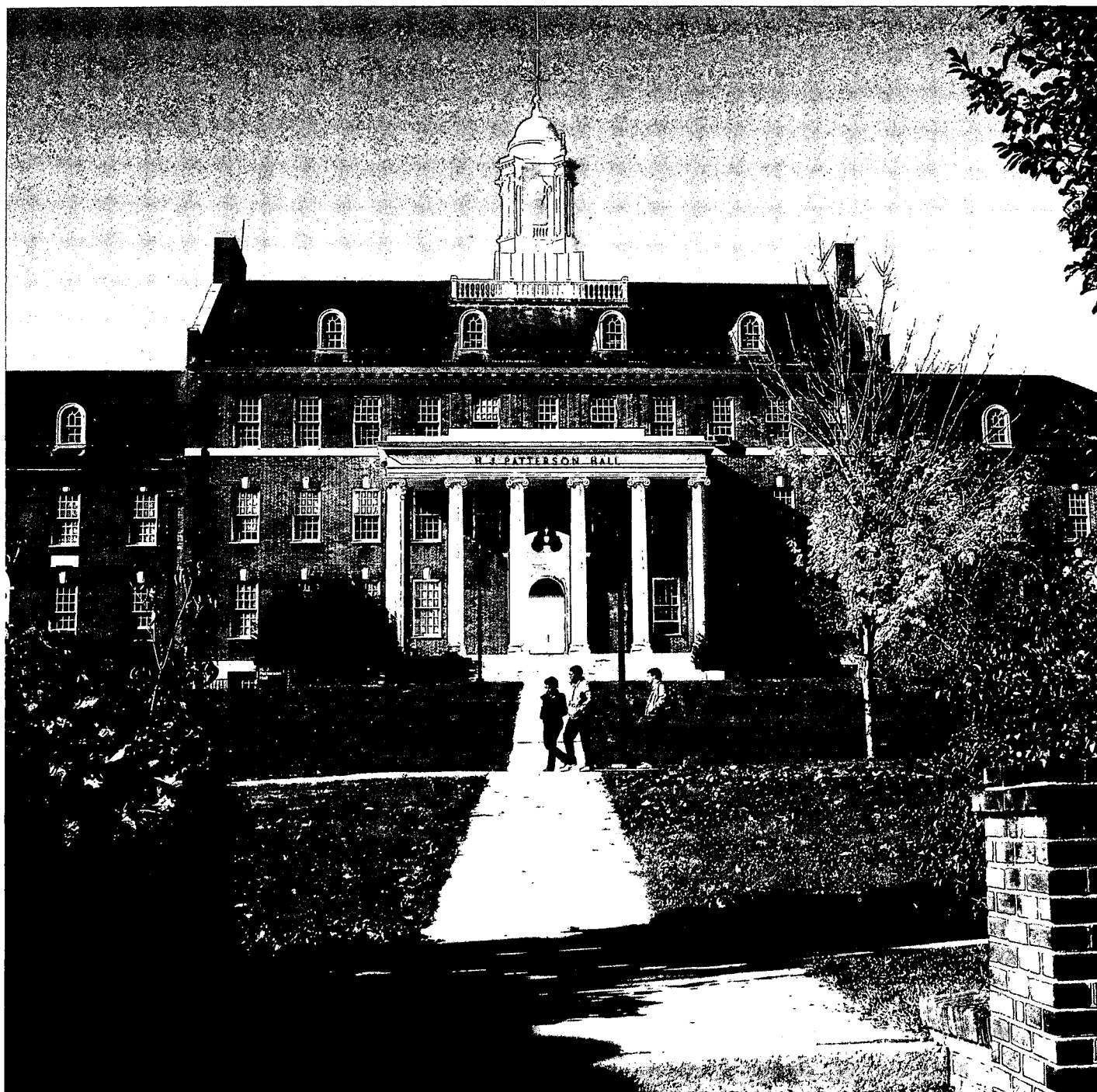
collateral civilian damage. Especially impressive were the men and women of the armed forces, most of whom appeared professional, resolved, confident, and articulate.

This testimonial, however, needs to be tempered by the realization that some aspects of the volunteer military and its associated total force policy became subjects of considerable interest, widespread debate, and a good deal of worry. Had the conflict become protracted or bloodier, the concerns about minorities, women, mothers, and single parents would have multiplied rapidly, surely eroding public support for what most Americans believed was a "just" war and, in the process, exacerbating racial divisions in American so-

With the deployment of American forces to the Persian Gulf, the nation as a whole suddenly noticed that mothers, single parents, and, in some cases, *both* mothers and fathers were being sent to a combat theater.

ciety. It is probable, too, that the Pentagon would have discovered, given the status of the Army combat reserves, that it had overestimated the nation's military capabilities.

Fortunately, with the quick end to Operation Desert Storm, these issues failed to develop into real problems. Understandably, the inclination now is to ignore them. But left unattended, they will return to haunt future military conflicts. Their unpredictable, but potentially damaging, military, political, and social implications argue strongly that they be resolved now, while memories are still fresh and while a fundamental rethinking of the post-Cold War U.S. military establishment is already under way. ■



MICHAEL S. MCPHERSON AND MORTON OWEN SCHAPIRO

Paying for College

Rethinking the Role of the States and the Federal Government

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Despite all the talk about the “skyrocketing” costs of higher education, the parents of many college students in the United States should probably pay more for their children’s education than they do. Four out of five U.S. postsecondary students attend state-run colleges and universities whose average cost (tuition plus room and board) in 1987–88 was \$3,960—just about one-quarter what it cost to house and educate those students.

States heavily subsidize colleges and universities to ensure wide access to higher education, and they have mostly succeeded in their goal. Access to at least some form of higher education is widespread for people from a variety of social backgrounds and economic circumstances. But because most state government dollars go to across-the-board tuition subsidies at public institutions, a great many public dollars go to pay for the education of students from affluent families who could well afford to pay more. In addition, the range and quality of the postsecondary opportunities available to lower-income students are often quite limited and vary substantially from state to state.

The states’ tab for providing higher education to their residents is huge—\$30 billion in 1985–86, the latest figures available, more than three and a half times what the federal government paid to provide grants and loans to college students. And the states’ ability to sustain that commitment is coming under serious pressure. Last February the Chancellor of the Massachusetts public higher education system resigned in protest over the governor’s proposed budget cuts. Thirty-eight states are facing budget deficits, while the burdens placed on state governments to pay for needed improvements in elementary and secondary education, growing public health needs, crumbling roads and bridges, and growing dependent populations continue to rise.

The time has come to reform the way our nation funds higher education. We propose a way to enable fiscally strapped states to charge students and their parents a larger share of what it actually costs the states to provide a college education—thus lowering state spending on higher education—without jeopardizing the educational opportunities of lower-income students and without putting an undue burden on middle- and upper-income families. Our proposal would link reform of state financing of higher education with thoroughgoing reform of the federal student aid program. It would shift the responsibility for paying for the higher education of lower-income students from the states to the federal government. And it would probably lower total government spending on higher education.

Reforming Undergraduate Education Financing

The key to our reform proposal is to expand and simplify the federal student aid program by concentrating all federal student aid subsidies in a single grant program. The current system provides subsidies not only through grants but also through subsidized loans. We propose to eliminate the subsidies associated with the

loans. Under our plan, the federal government would give grants to those who need subsidies, loans to those who need credit, and some of each to those who need both. The maximum grant (currently \$2,300) would be set at a level that approximates the cost to states of providing a year’s education at a typical two-year institution—some \$7,800, including residence costs—less a student contribution in the neighborhood of \$2,000. Grants could not exceed the student cost of attendance (and thus would be smaller for students attending a state school with total charges below \$7,800) and would decline with increases in the student’s family income, reaching zero at an annual income of about \$45,000.

Such a change in federal policy would provide states with a powerful incentive to raise their tuitions to cover a much more substantial portion of their costs. States could raise tuition without fearing that lower-income students would be unable to attend. Those states that did not raise tuitions would forgo substantial federal revenues because federal grants to their students would be limited to the student cost of attendance.

To the extent that states did respond by raising tuition, our proposal would involve a shift in the responsibility for paying for the education of lower-income students from the states to the federal government. What is the reason for such a shift? At bottom, we would argue that the concerns for fairness, equal opportunity, and human capital development that underpin federal student aid policy are fundamentally concerns whose costs should be borne by the federal government. More specifically, we believe that the changes we propose would improve the performance of all segments of the higher education system.

Many economists over the years have complained that the low tuition policies pursued by most states have some significant disadvantages. The problem is not just that subsidies are not targeted on needy individuals. In addition, public institutions are insulated from competitive pressures in the provision of education services to undergraduates, and private institutions are put at a disadvantage in competing with their public counterparts. The argument about competitive pressures is probably most telling at institutions that serve predominantly lower-income students. Such students typically have little choice about where to enroll under existing arrangements, particularly because they may be financially compelled to live at home.

How Would the New System Work?

So much for the theory behind our proposal. How would the proposed system actually work? Most states would raise their tuitions substantially, in order to capture the federal revenues. When the existing federal grant program began early in the 1970s, some states deliberately raised tuition rates. In 1972 the Keppel Task Force recommended that the City University of New York drop its zero tuition policy because “New York State students and institutions will fail to some degree to qualify for federal funds under the new statutes unless the public institutions charge higher tuition than they do at present. . . . We consider it ex-

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tremely important that the State take maximum advantage of federal funding in order to reduce the burden on state taxpayers." According to research we have done elsewhere, a one dollar increase in federal financial aid leads to a tuition increase at public four-year institutions of approximately 50 cents.

If states raise tuition enough to capture the increased federal spending fully, increased revenues to the states would substantially exceed added federal spending on student aid for students at public institutions—because higher tuitions would be paid by a great many students at public institutions who would not receive federal aid.

Some states might wish to devote some of these added resources to helping more affluent students who are not eligible for federal student aid cope with new higher tuitions. If, for example, states developed or expanded need-based aid programs for state residents, the new higher tuitions at state institutions would imply that even middle-or upper-middle-income students might qualify for aid, as is true now at many private institutions. Providing need-based aid to middle-and upper-middle-income students would, of course, re-

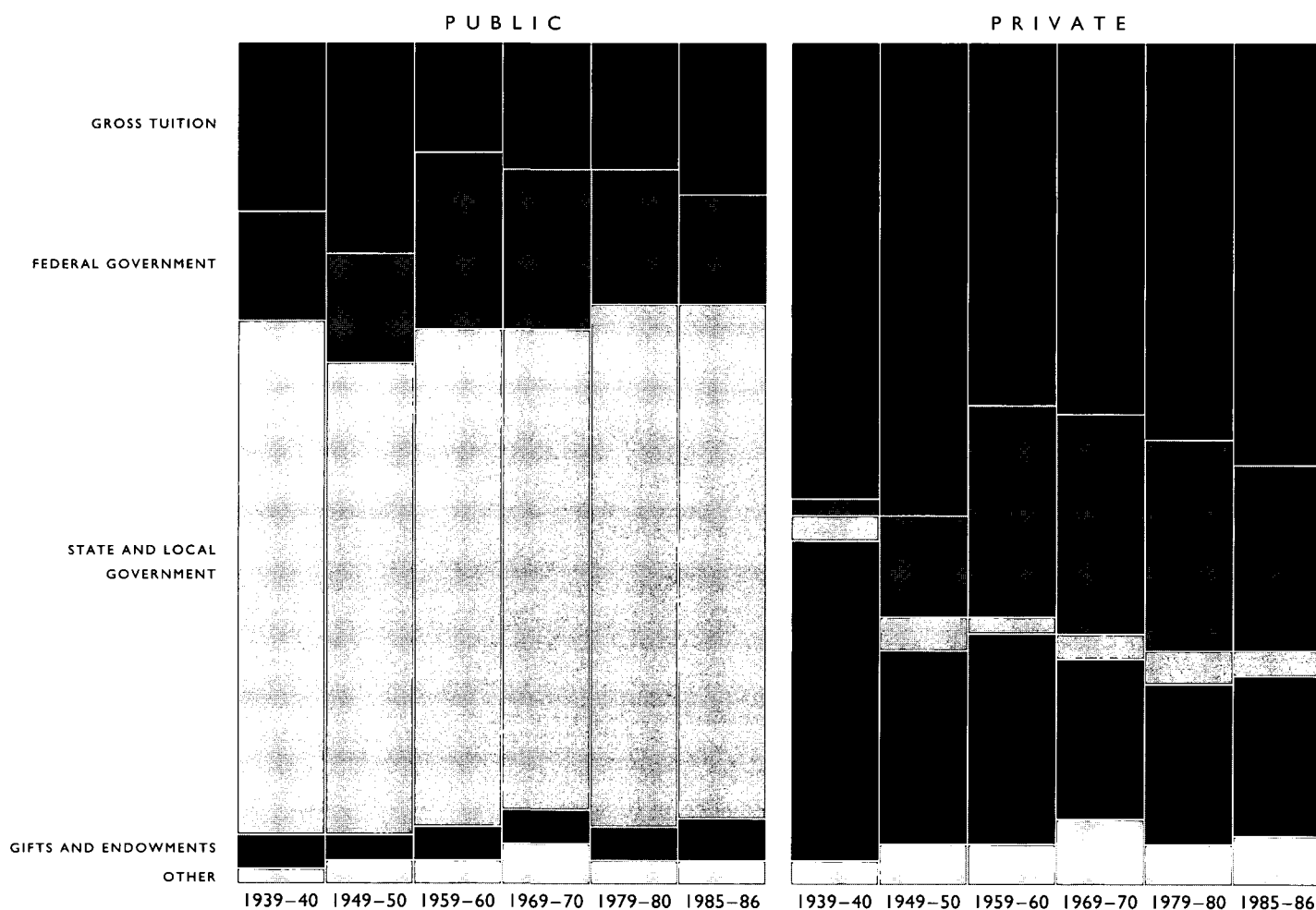
duce the redistributive consequences of the reforms we propose. But states that elected to increase aid to more affluent students would need to be explicit about whom they were deciding to subsidize and why—thus encouraging more enlightened public discussion of the issue.

Opening the Doors to Private Colleges

How would private institutions be affected by the reform we propose? Lower-income students are enrolled disproportionately in public institutions. Most who attend private colleges must receive substantial institution-based aid to be able to attend. Because few private colleges are able to provide grants covering all costs, lower-income students are discouraged from applying. Our expanded federal aid program would extend the range of choice for these students and increase their numbers in private institutions.

With the increased federal aid in effect substituting for at least a portion of the institutional grants to students, the question becomes whether such a transfer of public funds to private institutions is justified. Two considerations argue in favor of it. First, most of the

Figure 1. Revenue Sources of Public and Private Colleges and Universities, 1939–40 to 1985–86



Sources: For 1939–40 through 1959–60, Susan C. Nelson, "Financial Trends and Issues," in David Breneman and Chester E. Finn, eds., *Public Policy and Private Higher Education* (Brookings, 1978). For 1969–70 through 1985–86, *Digest of Education Statistics*, 1989.

Note: Revenue from auxiliary enterprises and sales and services is not included. Student aid revenues provided by governments appear under "gross tuition."

revenues that private institutions would receive from this program would be from increases in the numbers of lower-income students enrolled—and these payments should not be seen as transfers. Second, and more fundamentally, there is no reason to think that the education that lower-income students receive at private institutions is less valuable than that provided at public institutions; therefore, for those who need subsidies, it is just as productive for society to support their education in private as in public institutions.

Most private colleges and universities currently charge more than the maximum we are proposing and would thus have no incentive to increase their prices. The relative handful of institutions that now charge less than \$7,800 (including residence costs) would have an incentive to raise prices under our proposed policy, but that may not be a bad thing. Spending levels at such institutions are currently quite low, and higher tuition and spending might well bring commensurate quality improvements.

Private institutions whose costs were roughly comparable to those of public institutions would no longer find it necessary to supplement federal aid to make it possible for lower-income students to attend.

Because the maximum grant under the proposed program would be limited to \$5,800, high-cost private colleges and universities would find, under this regime (as under present policy), that their students have greater “unmet need” than students at cheaper institutions. It would make sense, then, for these institutions to continue to operate need-based student aid programs “on top of” the support provided by the federal grant program.

Nontraditional Students and Institutions

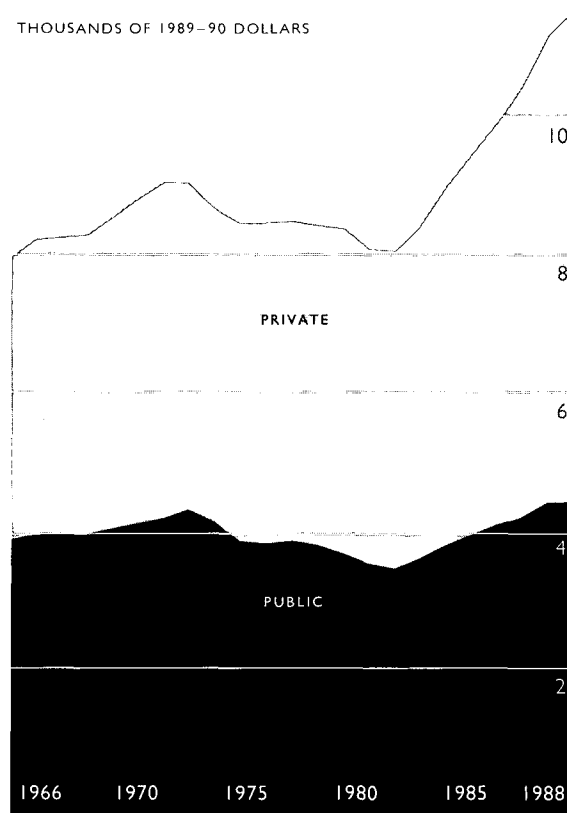
Under existing eligibility criteria, a large fraction of grants under the expanded federal program would not go to the traditional “college-age” students attending degree-granting institutions full time. Instead, a good deal of the aid would go, as it does now, to independent adult students, part-time students, and students in non-degree vocational programs at community colleges and proprietary (for-profit) trade schools.

It is not clear that such a result would be either equitable or efficient. First, existing needs analysis systems are less effective in identifying needy adults than in measuring “ability to pay” of the families of dependent students. And second, there is reason for doubt about the level of social returns to at least some post-secondary vocational programs, as well as to some forms of continuing education. At a minimum, it is not clear that all these activities are equally worthy of federal subsidy.

A final concern is that for-profit vocational schools are likely to increase their total claim on national resources significantly if federal aid becomes more generous. As we have noted, public institutions would be likely to raise tuition, but that increase would largely take the form of a transfer from federal to state governments, since state appropriations to these institutions would be likely to fall as tuitions rose. Most traditional private colleges and universities already have student charges that exceed the maximum federal aid level we

Figure 2. The Cost of Attending College, 1966–88

THOUSANDS OF 1989–90 DOLLARS



Source: Digest of Education Statistics, 1989

propose. In many proprietary trade schools, however, student charges and expenditures per student roughly equal the sum of the current maximum grant and loan subsidy—roughly \$5,000 per student. These institutions would have every reason to raise their charges to capture added federal support. Whether the added revenues would go for higher-quality programs is doubtful. To the extent that competitive pressures from well-informed consumers are effective, improved quality might be the result. But to the extent that these institutions could capture the added revenues as profit, it would plainly be in their interest to do so.

The Need for Clear Choices

All these concerns, about equity, efficiency, and levels of resource use, apply to the present vocational education system, but are obscured because existing federal subsidies to needy students are indirect and complex. Forcing more explicit social choices about what kinds of educational activities to subsidize, and for whom, is an added virtue of our proposal.

The point we want to stress is this: if the reform we are advancing here is a good one for traditional college-age students at traditional academic institutions, the existence of other groups of students and other kinds of institutions that receive support should not present an insurmountable obstacle to reform. If the goals of adult and vocational education are well served by grants to individual students, and if the social judgment is that these activities and populations deserve support equal to that given traditional students and institutions, then so be it.

But it is necessary to recognize that this is indeed a costly proposition. If, on the other hand, other delivery mechanisms seem preferable, or if, on balance, society is inclined to support these activities less generously than traditional student aid, then the necessary distinctions have to be made.

It is worth emphasizing that our proposed program might make more traditional academic programs attractive to some students who now enroll in vocational programs. More substantial grant-based funding would widen the range of academic alternatives that disadvantaged students could consider. Raising the purchasing power available to these students would also increase the incentive for institutions to be responsive to their particular needs and capacities. Undoubtedly, however, many men and women will continue to believe that their best course is to pursue vocational training, and they may well be right.

Our tentative recommendation would be to provide federal support for non-degree-oriented programs

and their numbers may increase if federal grant support for such programs becomes more generous. Educational opportunity is quite important for disadvantaged adults, and they should have access to federal support through the expanded grant program. A needs analysis system for such students should, however, aim to meet three criteria that the existing system meets only imperfectly. First, the subsidy system should avoid creating incentives for students to move voluntarily from dependent to independent status. Second, the system should require a contribution from independent students that is larger than that from the parents of dependent students in comparable financial circumstances. And finally, the system should base its assessment of the student's ability to pay not on resources while he or she is enrolled in school, but on resources over several years beforehand.

Reforming Federal Loan Finance

Our proposal would preserve guarantees for federal student loans, but eliminate interest subsidies. A subsidized loan can usefully be thought of as a package of a grant and a smaller unsubsidized loan. Packaging the two together makes it hard to target both subsidies and credit access at the right group, and confuses both policymakers and borrowers about just what is going on.

The federal government could provide unsubsidized loans either through a guarantee mechanism for loans generated through banks, as in the present Guaranteed Student Loan system, or through a direct lending system, operated through schools, which would rely on federally provided capital. In terms of the fundamental economics of the matter, there is little to choose between the two. It would probably be best for a healthy direct lending system to operate in parallel with a guarantee system, partly as a potential source of institutional innovation, and partly as an alternative source of credit should banks for one reason or another withdraw from the program or fail to provide credit to certain groups of students.

If loans are unsubsidized, would they generate unreasonably large repayment burdens for students? That worry is unnecessary because we are proposing to divert the resources that currently subsidize loans into direct grant subsidies instead. Suppose, for example, that a particular student would qualify for a grant equal in value to the subsidy she would otherwise have received for a loan and that her costs of attending college are not otherwise affected. Her borrowing requirement is reduced by the grant just enough that the repayment burden for her loan is exactly what it would have been before. Obviously, if this equality held for everyone, there would be little point to changing the loan subsidies into grants. The advantage of making the separation is precisely that it is possible to make a direct policy judgment about the best way to target all the grant funds and then meet remaining credit needs as a separate matter.

Budgetary Implications

The budgetary and enrollment consequences of implementing these reforms would depend critically on the responses both of students and of colleges and universities to changed student financing incentives.

The Shrinking Federal Student Aid Grant, 1977–78 to 1987–88

YEAR	MAXIMUM GRANT	STUDENT COST (TUITION, ROOM AND BOARD)	MAXIMUM GRANT AS PERCENTAGE OF STUDENT COST
1977–78	1,400	2,411	58.1
1979–80	1,800	2,809	64.1
1981–82	1,670	3,489	47.9
1983–84	1,800	4,167	43.2
1985–86	2,100	4,885	43.0
1987–88	2,100	5,510	38.1

Sources: Pell grant data are from The College Board, *Trends in Student Aid: 1980–1989*. Cost data are for all institutions and are from *Digest of Education Statistics, 1989*. Figures for 1985–86 and 1987–88 are estimates.

and short-term vocational training through contracts with providers. Institutions offering vocational training would contract with the federal government, or perhaps with state government agencies relying on federal funds, to supply training to students whose eligibility would be decided jointly by the funding agency and the provider. Students would not pay tuition. Rather, educational costs would be covered by the contract. Living costs might be subsidized directly by the government. Such an arrangement would permit the government to impose performance standards, tailor the supply of training in various fields to regional labor market conditions, and control the costs of the training provided.

Placing these programs under separate authority would, in itself, introduce a significant change in the treatment of adult and independent students, since many of them are enrolled in vocational and other non-degree programs. Indeed, such a reorganization might encourage more effective techniques for determining adult eligibility for such programs.

Many adult and independent students will remain interested in pursuing an academic postsecondary ed-

If public institutions do not raise prices at all in response to increases in federal grant increases, the bulk of added federal grant awards would go to students in private higher education. Because most students are enrolled in public institutions, the cost of the expanded grant program would be small—some \$2.9 billion, by our estimates, of which \$2.1 billion would go to students at private institutions and about \$0.8 billion to public institution students.

If public institutions raise their prices enough to fully qualify their students for increased federal aid, students at public institutions who currently receive grants would find their grants increased substantially, to help offset the higher tuitions, and many students who are not now eligible for grants at public institutions would qualify. Added costs at public institutions would, we estimate, total some \$12.2 billion a year. The costs of added grants at private institutions would, as before, total \$2.1 billion.

Our guess is that the most likely outcome would be somewhere between the two extremes—probably an increase in the cost of the federal grant program of some \$10 billion.

There are, however, important offsets to these added costs. First, the cost of other federal programs would be reduced under our proposal. The three campus-based programs for direct lending, supplementary educational opportunity grants, and work-study would be eliminated, resulting in a saving of about \$1.2 billion. Eliminating interest subsidies would also bring significant saving. New accounting rules agreed to as part of last fall's budget accord will force Congress for the first time to recognize that when it authorizes a new loan, between 30 percent and 50 percent of the cost of that loan will be borne by the federal government, with more than half of that being subsidized interest cost. With no change in loan volume, eliminating the interest subsidy would save the government between \$1.4 billion and \$2.3 billion a year.

Even more important would be the saving on state budgets resulting from the increases in public tuitions. If colleges and universities raise tuition to an average of \$7,800, revenues would increase about \$23.2 billion. Even if the tuition increase were only half that large, the revenue increase would be \$11.6 billion. Unless states rebate part of the increased tuition through expanding their own student aid programs or through increasing spending per student, the net effect would be to reduce total government spending on undergraduate education.

Shifting the Burden

Although no one can be sure what the future holds, the ability of state governments to continue to finance high-quality postsecondary education while keeping tuitions low for all students is likely to be sorely tested in the years ahead. Without real changes in the financing system, the educational opportunities of lower-income students would be severely threatened by such a development.

Our proposal would involve a substantial increase in federal spending compensated by reductions in state spending. In recent years, much of the fiscal move-

ment has been in the opposite direction, with federal budgetary constraints leading to increasing fiscal burdens on state governments. During the 1980s, state budgets appeared to be in much better shape than the federal budget. Now, although the federal budget continues to be in substantial deficit, the ability of state governments to increase their budgets appears to be reaching its limits. Proposals like ours, which would move some responsibilities away from state budgets toward the federal budget, may be more plausible in the 1990s than they would have seemed in the recent past. Moreover, some of the most pressing needs facing the nation fall into areas that are more clearly state and local responsibilities than is the financing of higher education. As we noted at the outset, states are increasingly hard pressed to respond to needs for investment in public infrastructure, in health care, and in elementary and secondary education, among other areas. As proposals to address these and other areas of need continue to come forward, further straining state budgets, the idea of including some fiscal movements in the other direction in a policy "package" may have appeal. Further pressure in this direction might arise from state-level "tax resistance" referenda and from national-level proposals, such as restricting the federal deductibility of state tax payments, which make it more difficult for states to raise taxes.

Part of a Bigger Fiscal Package

The reform we have outlined could be accomplished only over a substantial period. Although the reform would not raise the national public costs of higher education—and conceivably could lower them—it would call for a dramatic redistribution of financing responsibilities among levels of government, which would probably need to be worked out as part of a larger package of fiscal reorganization.

Moreover, the proposal would conflict with the real or perceived interests of some crucial elements in the national college finance effort. Banks will not want to lose student loan subsidies. Public colleges will not uniformly welcome incentives to raise prices (even if they are compensated for some students by higher aid). Private colleges will be concerned that our program does not give bigger grants to students at more expensive schools. And vocational programs will be unsettled by the thought of having their support diverted to other funding channels.

We believe that our proposal would actually have significant benefits for some of the groups who might focus on these costs. Private colleges, for example, might benefit significantly from the improvement in their competitive position resulting from higher public tuition. Public colleges and universities who succeed in serving students well will benefit from funding mechanisms that are more sensitive to student choice. Some for-profit institutions and community colleges might find a contract funding mechanism quite effective for their purposes. More important than its appeal to various interest groups, the revision in funding that we propose would advance the interests of students and of the nation in a more competitive and equitable higher education system. ■

The Search for Peace: Prospects for Arab-Israeli Negotiations

The United States finds itself once again in the unrewarding role of trying to prod reluctant Israelis and Arabs to the peace table. Frustrating as the role is, U.S. interests in the Middle East demand that we take it on.

Simply put, our interests are oil and Israel. As the largest importer of oil in the world, the United States cannot be indifferent to the terms on which oil from the Persian Gulf is available to the world. While we may not care much whether Gulf oil costs \$15 a barrel or \$25 a barrel, we and our allies have a vital interest in a relatively predictable supply and minimal price fluctuation. Extremes of very low or very high prices can be disruptive to the world economy. Thus, Gulf security is understandably a big concern.

The U.S. commitment to Israel, while not rooted in concrete economic interests, is at least as compelling as our Gulf interests. For historical, moral, and political reasons, the United States finds itself tied to the existence and well-being of a Jewish state in at least part of the former British mandate of Palestine. No U.S. president would turn his back on Israel if its vital security were endangered.

Progress toward Arab-Israeli peace would help protect both sets of American interests. Moderate forces in the region would be strengthened; the existing peace between Egypt and Israel would be reinforced; and American leadership would be enhanced. The question is whether our efforts can succeed in light of regional political realities. And, if so, what concrete steps will get the peace process under way.

No leader in the Middle East is so eager for peace that he is prepared to make enormous sacrifices. And no one has much confidence in the intentions of the other side. In short, leaders and their publics are unsure whether they will be better off or worse off with a peace agreement.

As in the past, progress toward peace will be made only if the United States engages itself at the highest level and provides substantial inducements for progress. We may deplore this fact, but that changes nothing. Arabs and Israelis alike remember that after the 1973 war, Nixon and Kissinger made an all-out effort to reach partial

agreements. And from 1977 to 1979 Jimmy Carter devoted much of his time to Arab-Israeli issues. In each case, the United States played multiple roles—catalyst, mediator, bully, friend—as it tried to persuade the parties to the conflict to make compromises for the sake of peace. President Bush and Secretary Baker are the inheritors of this process, and the parties are testing them now to determine how hard we will press and how big the payoffs will be.

I do not want to underestimate the difficulty of moving the peace process forward. The conflict between Israel and its neighbors touches on key substantive issues. Who will control the Golan Heights, the West Bank, and Gaza? What will be the status of Jerusalem? What security arrangements will be in place? How credible will commitments to peace really be? What guarantees, if any, can be provided by outside powers? If and when peace talks begin, the real issues of contention will be these, not the role of the United Nations or the frequency of convening a plenary session of the peace conference. And here we will encounter difficulties.

Any attempt today to design a comprehensive Arab-Israeli peace agreement is bound to be rejected by the parties. Still, some broad principles do need to be articulated. Between Syria and Israel, the issues are fairly straightforward. In one form or another, the Golan Heights should remain a buffer zone between the two countries. The precise political formula, the security arrangements, and interim steps will all have to be subjects of negotiation. Syria cannot be expected to negotiate unless the future of Golan is on the agenda. Israel cannot be expected to negotiate if it is required to make a prior commitment to full and unconditional withdrawal.

Then, of course, there are the political issues: the nature of the peace agreement, recognition, diplomatic relations, and Syria's role, if any, in the settlement of the Palestinian problem. These are tough issues, but they do not involve core ideological values in the same way that the Israeli-Palestinian conflict does.

The Shamir government adamantly refuses to acknowledge that withdrawal from at least part of the West Bank is the price it

must pay for peace with the Palestinians. But Israeli public opinion is far less categorical. What is needed, then, is a concept for an interim agreement that goes a considerable distance toward ending the occupation regime, while leaving Israel with control over essential security matters, and a workable concept of a three-way political confederation of Israel, Palestine, and Jordan that could emerge from the transitional arrangements. Creative political thinking will be required to fit the simultaneous needs of distinctive political identities, economic interdependence, and Israeli maintenance of a dominant security position.

While daunting, these issues are not beyond the skill of diplomats to tackle. But for negotiators to do their job, talks must begin, and an atmosphere conducive to compromise will have to be created. That is what the administration presumably is trying to achieve. One issue needs special attention—the continuing Israeli program of building settlements and the expropriation of land in the West Bank. President Bush is correct in identifying this as a real problem. With the massive influx of new immigrants, it is likely to become more of an obstacle to negotiations. While we may not be able to persuade the current Israeli government not to build more settlements, we do have an important source of influence on this issue. Israel will soon be formally requesting additional aid to house new immigrants. The total request may be for \$15–20 billion over the next five years.

By attaching conditions to this aid—no more settlements, no more land confiscation—and by linking such aid to progress in peace talks, we may find that we have considerable impact on the internal Israeli debate. And that debate is essential if the peace process is to move forward. Israelis will go to the polls next year, many of them voting for the first time. If ordinary Israelis see that their neighbors are ready to sit down and negotiate, and if they see their economic future as improving in conditions of peace, perhaps there will be a shift toward a government that more accurately reflects Israeli public opinion. (A recent public opinion survey showed that 36 percent of Israeli Jews supported some form of annexation of the territories; 35 percent supported some degree of territo-

rial withdrawal; and 29 percent favored the status quo or some form of autonomy.)

We have recently heard talk of a “window of opportunity” for Arab-Israeli peace negotiations. Like most clichés, this one has only limited value in clarifying a much more complex reality. But there is truth in the observation that we face one of those moments when progress in Arab-Israeli negotiations may be possible. Sizeable constituencies in both Israel and many Arab countries are ready to make concessions for peace. But the mere fact that many Arabs and Israelis are fed up with the wasteful, unending conflict does not mean that peace is about to break out. A useful analogy may be found in arms control negotiations. Once the predisposition to limit the arms race took hold in the 1960s, actual agreements were still many years in the making, and the process continues to this day. Similarly, in the Arab-Israeli arena, we should think in terms of a lengthy exercise, with numerous pauses along the way for the parties to get used to new realities. But starting the process, and keeping the destination in sight, are essential.

This brings us to the American role. We cannot force the parties to make peace. But we can help to structure their incentives and to clarify their choices. President Bush seems to have the right instinct in believing that this is a time for American leadership. And Secretary Baker seems to possess the requisite patience and negotiating skills. Now they need to show determination—and vision.

In deciding to tackle the Arab-Israeli conflict, the administration surely does not expect to pull off the diplomatic equivalent of “Operation Desert Storm.” Victory will not come in a matter of months. The process of peacemaking is likely to drag on and to be immensely frustrating. Even those who have succeeded—Nixon and Kissinger, Carter and Vance—did not find the exercise to be very uplifting. Nor was there political gain to be had on the domestic front. On the contrary. But few would contest today that American interests were well served by the achievement of Egyptian-Israeli peace. The same will be true if the administration’s current efforts bear fruit. ■

William B. Quandt

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Improving Our Criminal Justice System



Can We Borrow from Europe's Civil Law Tradition?

Charles Maechling, Jr., an international lawyer and former State Department official, led a study of European criminal justice systems while a visiting fellow at Wolfson College, Cambridge University, 1985–87. An earlier version of this article appeared in the American Bar Association Journal (January 1991).

The American criminal justice system is breaking down. Court calendars and prisons are clogged. It can take years to execute a child murderer or put a rapist behind bars, while an otherwise harmless teenager can get a mandatory 20-year sentence for mere possession of cocaine. One Southern state recently sentenced an ignorant black youth to five years at hard labor for shoplifting a \$6 item.

One cause of the simultaneous harshness and ineffectiveness of the U.S. system is something Americans take so for granted that it never occurs to us to question it—the adversarial nature of our courts.

All European countries except Great Britain and Ireland, and nearly all third world countries that have a European cultural heritage, employ variations of the so-called inquisitorial criminal justice method, which grew out of the 2,000-year tradition of the civil or Roman law. Only the Anglo-Saxon countries cling to a judicial parody of the medieval tournament—lawyers for the state and the defense fight for the body of the accused before a judge as umpire and a jury carefully selected for its ignorance of the personalities and issues before it.

In the Anglo-American system, the narrow focus on the accused, coupled with the disproportionate power and authority of the state, necessitates a bristling array of constitutional safeguards and procedural rules to level the jousting field and protect the defendant's rights. The tournament, or trial, is the supreme event. Nothing in the prior stages of the criminal justice process has any validity until proved to the satisfaction of the jury in open court.

Anglo-American trial procedure has a limited purpose—to enforce the tournament rules. The function of the trial is not to establish the truth about the facts of the crime. As any law graduate will attest, it is to provide the prosecution with a forum to convince the jury beyond a reasonable doubt that the accused is guilty of the specific crime he is charged with, and nothing else.

The process requires the prosecution to present its case in the most awkward way possible—through a succession of witnesses, each of whom lifts the curtain on a separate aspect of the events in question. Each witness is held to the confines of his own personal experience; the last thing a witness is allowed to do is tell his story in his own words and give his opinion of what it means.

Moreover, to lend credibility to his testimony and avoid having it discredited on cross-examination, the witness must profess absolute certainty about what he saw or heard. That leaves the veracity of trial testimony always open to question since the police record of statements made by witnesses at the time has no probative value of its own, and the average person cannot, without coaching or prompting, remember the details of events that he witnessed the week before, let alone six months or a year ago.

Another distortion is imposed by the hearsay rule. In the adversarial process the jury is not allowed to hear what the witness says another person told him he heard or saw at the time. The only exception in

Britain, Canada, and some other jurisdictions is what the accused told the witness or may have said in the latter's presence. The hearsay rule wipes out a whole area of valuable information that is especially useful in the prosecution of conspiracies, racketeering, and white-collar crime.

An artificial obstacle now more or less unique to the United States is the exclusion of illegally seized evidence. No reasonable person would question that the Fourth Amendment prohibition against unreasonable searches and seizures is an essential freedom of a democratic society. But why it should be allowed to interfere with criminal prosecutions and, under the "fruit of the poisonous tree" doctrine, bar legally obtained evidence as well defies common sense.

There are plenty of remedies, from disciplinary penalties to civil liability judgments, to punish violators of civil liberties without withholding critical information from juries. Former Chief Justice Warren Burger pointed out in a well-known Supreme Court opinion that there is no empirical evidence that the exclusionary rule deters unreasonable searches and seizures. The rule in Canada, Britain, and other Anglo-Saxon countries is that the means of obtaining evidence has no bearing on its admissibility in a criminal trial.

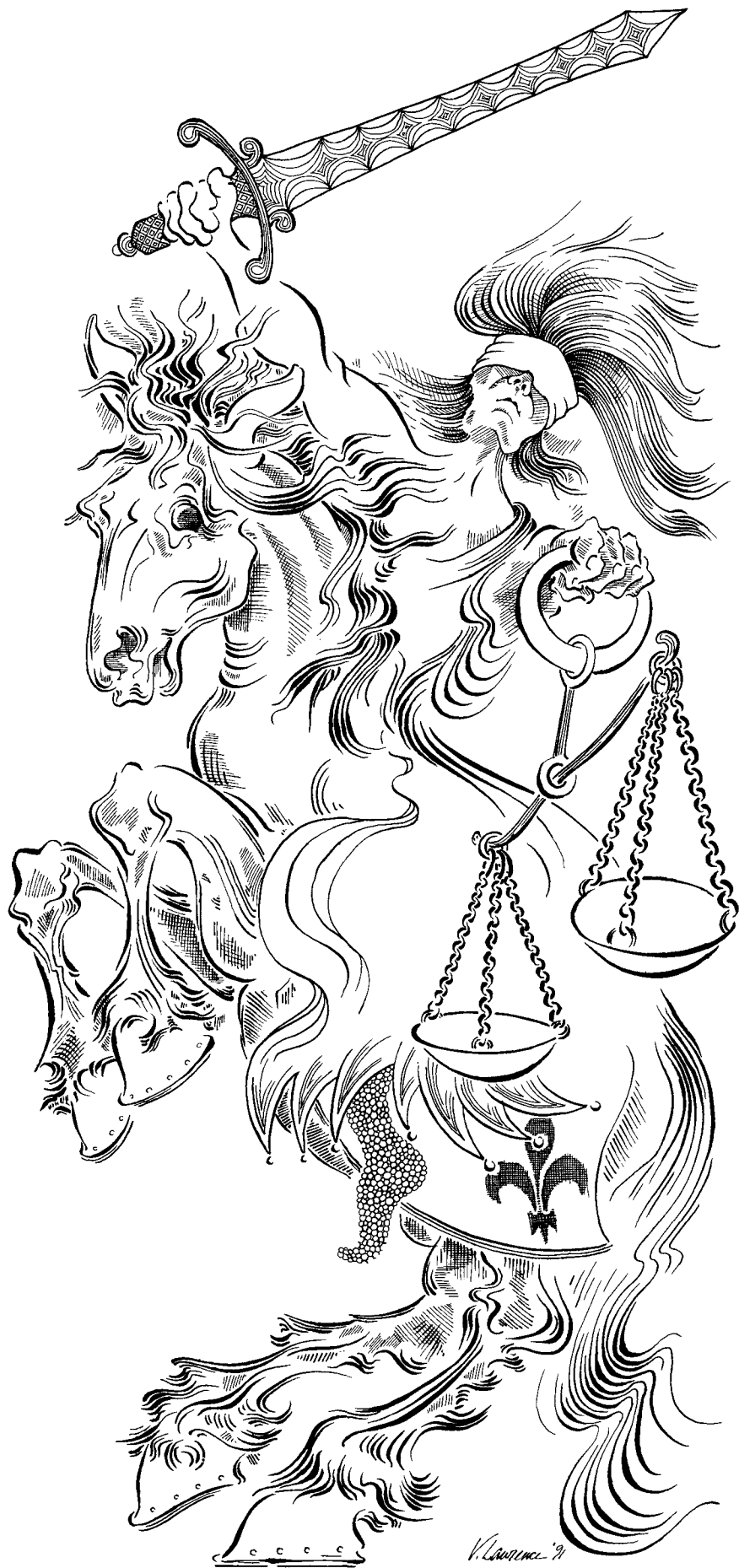
Even more irrational is the way the traditional English prohibition against self-incrimination has been pushed to an extreme by Supreme Court extensions of the Fifth Amendment. This relic of the Star Chamber was intended to protect an accused in a criminal trial from confession under torture or extreme duress. There has never been a sound rationale for allowing the rule to obstruct introduction of testimony given in other forums, such as congressional inquiries.

In Canada, for example, a witness cannot refuse to answer a question on the ground that it may tend to incriminate him, although that specific question and answer may not be used in any trial or civil proceeding where he is a defendant. The most outlandish extension of the Fifth Amendment to date, unwarranted by any ruling of the Supreme Court, was the decision of the Iran-Contra special prosecutor to forbid his staff to read relevant congressional transcripts and newspaper accounts.

The System at Its Worst

The adversarial system is at its worst in the ritual of cross-examination. The witness who tries to give a frank and honest statement of his observations, impressions, and beliefs, with all the necessary qualifications, will find his recollection and indeed credibility challenged at every step. In most cases he will be forced to retract or at least to restate only those portions that he can testify to with precision and absolute certainty. Ostensibly designed to narrow testimony down to a hard core of "fact," cross-examination more often confuses the witness and muddies the record. That is exactly what the cross-examiner intends. His object is to seize on contradictions and uncertainties to discredit the witness.

As noted British criminal law jurist Professor P.A.J. Waddington pointed out last year in a *Times* of London article, "The aim is not to find out how much or



in which respects testimony can be relied on. It is a zero-sum game in which evidence must be accepted as wholly true or worthless.”

Deprived of a great deal of relevant information, and forced by the rules to receive what is deemed admissible in piecemeal form removed from real-life context, the jury is required to determine guilt or innocence on the narrowest grounds possible.

The choice is not “what, if anything, did the defendant do that was against the law?” but “did the defendant do exactly what the prosecution alleges?” Unless specified in the indictment, there is no possibility, for example, of convicting an accused of arson as well as burglary, no matter how overwhelming the evidence that emerges at trial that he set fire to the house he burgled.

The mock tournament aspects of the accusatorial process are also prejudicial to the accused. Since the prosecution needs to build a bullet-proof case beyond reasonable doubt, it tends to accumulate only information that reinforces the initial presumption of a suspect’s guilt, and to disregard or discount information that contradicts or qualifies it. The need to establish criminal intent also puts a premium on over-certainty, pseudo-precision, and one-dimensional interpretation of the evidence by the prosecution.

Two other abuses that spring from the accusatorial process are the plea bargain and the temptation to fabricate evidence. The plea bargain does little damage to the integrity of the system as long as it is limited to one individual. It has the practical benefit of saving the state from the expense and effort of time-consuming trials and appeals that overload the system.

But once transformed into an instrument for con-

victing conspirators and codefendants, it opens the door to dishonesty and gross injustice. A criminal defendant who breaks with his confederates and succumbs to the lure of a light sentence or no sentence at all is likely to give the prosecution everything it wants—testimony to incriminate others, embellished with all requisite certainty.

Worse, plea bargains are increasingly made with the defendant in the best position to implicate others—not with a minor accomplice to nail the ringleader. In the John Walker espionage case, for example, the mastermind of the ring was allowed to plea-bargain his way to a light sentence, while his hapless brother-in-law, pressed into service virtually against his will, received a sadistic 25-year sentence without parole for turning over one low-grade security item.

Civil law countries reject the plea-bargain practice as tainted and make it a bar to extradition.

Criminal Justice by “Inquiry”

The civil law tradition that governs the countries of Western Europe, and that has been retained in Eastern Europe as well, proceeds from premises so different from the Anglo-Saxon tradition that it can easily delude Americans into imagining the worst.

For starters, the name “inquisitorial” applied to a criminal justice process conjures up “inquisition” rather than the actual derivation from “inquiry.” The notion that justice can be served by objective methods of inquiry rather than by pit-bull confrontations in a judicial arena leaves the average American uneasy about his ability to fight back. This is especially true if he assumes that in Europe the accused is presumed guilty until proved innocent.



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of the medieval tournament—lawyers for the state and
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The inquisitorial process does not make the trial the supreme event in the way the accusatorial process does. It is rather the public finale of an ongoing investigation.

In a felony case the process breaks down into three stages—an initial investigatory phase, conducted by the police; an examining phase, conducted by an examining magistrate; and the trial, conducted by the state prosecutor before a small panel of judges, supplemented in some countries by lay judges or a small jury. The examining phase is both a more detailed investigation and a preliminary *in camera* trial to determine whether the case against a suspect is strong enough to bring him before a more formal tribunal.

The task of the magistrate in the examining phase is to develop and assess all the information surrounding a crime. At issue is not only what is produced by the police during the investigative phase but what is subsequently extracted by the examining magistrate from the witnesses, physical evidence, and information provided from other sources.

Building Up the Record

In the civil law system, the *dossier*, or official record, plays a crucial role. Every relevant scrap of information about the case and the individuals involved in it goes into the *dossier*. The task of the examining magistrate is to sift through this material, weigh it for what it is worth, and decide whether it adds up to a *prima facie* case.

Well into the examining phase, the focus is likely to be on the event rather than on a particular suspect. Thereafter, the emphasis is on building a coherent case based on all the information available. As the case is built, corroborative evidence pointing to one conclusion is accumulated, but that conclusion is always left open to challenge by new evidence and contradictory testimony.

Hence, a great deal of the examining magistrate's time is taken up in examining and reexamining witnesses and taking supportive affidavits. Since one of the magistrate's principal concerns is resolving contradictions, witnesses are often summoned to directly confront each other or the principal suspect. During the examining phase, a suspect may have his counsel present at any time during questioning, but counsel is not usually allowed to question witnesses himself, although he is free to point out anomalies in their testimony and request lines of questioning on behalf of his client. In some respects the procedure is similar to a congressional committee hearing.

Only after completion of the examining phase and resolution of any ambiguities and uncertainties will the examining magistrate decide whether to bring a suspect to formal trial. By this time all other suspects will have been washed out, and much of the function of the accusatorial trial fulfilled. At this point, the burden of proving innocence does in a sense shift to the accused, since he would not reach the trial stage at all without a strong *prima facie* case against him. Nonetheless, he is entitled to a public trial to prove his innocence, or, more likely, to show extenuating circumstances.

At the trial, the public prosecutor will present the

case against the accused by in effect distilling the *dossier* into coherent form, not in rehashing its content through the testimony of one witness after another. Witnesses may, however, be requested by the defense to refute the information in the *dossier* or by the court to resolve crucial questions or apparent anomalies. The court does the questioning, although the lawyers may cross-examine. All witnesses are the court's witnesses, though either side may propose them.

The function of defense counsel is to make legal arguments to the court, to open and sum up for the accused, and to advise the accused at every stage of the proceedings. He cannot disrupt the proceedings with delaying tactics and frivolous objections on points of procedure.

Rights of the Defendants

In civil law jurisdictions, the rights of suspects and defendants are safeguarded, but not in the same way as here or in other Anglo-Saxon countries. In the civil law world the process itself provides safeguards. As noted, the focus is initially on the event, not the person—first, to determine whether a crime took place and only thereafter to zero in on a particular suspect. The accused has the right to counsel almost from the moment of his arrest and can refuse to answer questions. However, a negative inference may be drawn from his refusal to answer, and anything he does say may be used against him.

The admissibility of all evidence for what it is worth can also work in his favor. Background information that in an adversarial proceeding would be ruled irrelevant until sentencing can be introduced at any stage to show mitigating circumstances. Judicial rulings and sentencing will be the product of the collective judgment of a judicial panel and not dependent on the arbitrary judgment of a single, all-powerful judge.

In the United States, the sanctimonious maxim that "Ignorance of the law is no excuse" puts every citizen at risk. What may have been a sound rule in simpler times, when the catalog of punishable offenses was limited to traditional offenses like murder, robbery, rape, and larceny, becomes a sinister joke when applied to the five-foot shelf of the U.S. criminal code and the even more voluminous statutes of individual states.

Moreover, in the United States a citizen cannot rely on the plain meaning of a statute, or what passes for it. He must retain a lawyer to parse its legislative history and judicial evolution. So many forms of social and economic activity have now been criminalized that the discretionary power of federal and state authorities to pick and choose targets for prosecution has made enforcement utterly arbitrary.

In the case of the tax codes, not one citizen in 10 million can tell whether he has committed a trivial error or subjected himself to the risk of a felony conviction. In addition, by a grotesque inversion of legal principle, the burden is on the taxpayer to prove his innocence.

By contrast, a citizen of Switzerland or Denmark, to name only two examples, keeps on his bookshelf,

next to the family Bible, a complete compilation of the civil and criminal codes of his country in a volume no larger than a thick pocket dictionary. Following the Roman tradition, statutory language is terse, uncomplicated, and comprehensible to all. The traditional catalog of crimes is considered adequate for even sophisticated forms of economic malfeasance.

The Abuse of Perjury

Another hazard for the U.S. citizen, rare in civil law countries, is the use of perjury to put an accused behind bars when the evidence is either insufficient or inadmissible to convict him for the charged offense. In civil law countries the oath is of less significance. It is assumed that most people lie or conceal the truth when their vital interests are at stake. In any case it is the totality of corroborative evidence that counts, not the answer to any particular question.

The American version of the accusatorial process, which emphasizes the extortion of “yes” or “no” answers, can easily turn cross-examination under oath into a game of entrapment. Under skilled cross-examination, any witness, denied the opportunity to recount his experience in his own words, is likely to commit perjury not once but several times, especially if the subject matter is complex and the events took place long ago.

The fact that prosecution for perjury is often used to “get” a controversial public figure—Alger Hiss is the classic example—in itself induces public cynicism and suspicion. For the government to fall back on a minor procedural charge when, if credible evidence were available, it would otherwise prosecute the suspect for a serious offense smacks of persecution.

As might be expected from the ancestor of the accusatorial model, the British version shares many of our system’s shortcomings. But thanks to English pragmatism, the absence of a written constitution and Bill of Rights, and the high priority the British public gives to law and order, the British system is neither snarled in red tape nor befogged by democratic ideology.

In Britain, the accused is protected from self-incrimination in court, but any statements he makes in other contexts or after a Miranda-type “caution” may be used against him. Since the media are prohibited from publishing any information about a criminal suspect before the trial, the need to disqualify jurors for bias seldom arises.

The nature of the British legal establishment virtually ensures a smooth and expeditious criminal justice process. Trial lawyers for both prosecution and defense are drawn from the same elite pool of qualified barristers. High Court and appeal judges are appointed from the ranks of senior barristers. Procedural rules are straightforward and relatively simple. Barristers owe their primary duty to the court and not to the client. And since everyone plays by the rules, there are none of the disruptive outbursts, histrionics, and dilatory tactics that disgrace American criminal trials.

Furthermore, paperwork is kept to a minimum. Objections and motions are rarely reduced to writing and almost never appealed. If there is a dispute over a point of law, the law books are handed up to the

judge, who makes a ruling on the spot. The sentence usually follows immediately after the verdict. The trial transcript is generally considered sufficient for an appeal, which is processed in 90 days or less and, except in unusual circumstances, is confined to review of the evidence.

Can the U.S. System Be Fixed?

Whether the deficiencies of the American adversarial method can be rectified is an open question. Indeed, at first glance, the U.S. Constitution and Bill of Rights do appear to raise insuperable barriers to change.

But closer examination will reveal that many of the anachronisms discussed above are not anchored in the specific language of the Constitution. They are either the products of later interpretation by the Supreme Court or derive from British precedents that, in turn, trace their origins to medieval abuses and the long struggle for power between Parliament and the Crown. Illustrations abound.

There is, for example, nothing in the Bill of Rights that requires that evidence procured in violation of the Fourth Amendment prohibition against unreasonable searches and seizures be inadmissible in court. On the contrary, the early history of this provision indicates that it was designed to protect private property and the sanctity of the home—to stand on its own feet with its own penalties, rather than to interfere with the prosecution of criminals. The exclusionary rule in federal courts dates back only to 1914, and in state courts to 1961. In 1949 Justice Felix Frankfurter in a Supreme Court opinion invited Congress to overturn the rule.

As another example, the Fifth Amendment prohibition against self-incrimination could be restored by the Supreme Court to its declared purpose of preventing self-incrimination in a criminal case against the accused, and removed as an excuse for allowing a defendant to evade truthful responses in congressional inquiries and other forums.

The archaic rule against admission of hearsay evidence—the kind of information governments and ordinary people use daily to make decisions—finds no mention in the Constitution and could be eliminated at a stroke by legislative fiat.

There is no reason to disqualify the best educated and better informed citizenry from jury duty simply because they have acquired general knowledge of a crime or personality from the news media, as in the Iran-Contra trials. The Sixth Amendment requirement of impartiality need not be a mandate for political illiteracy.

Nor is there any reason why all witnesses in a criminal trial—especially “expert” witnesses now carefully selected by each side for their biases and coached to give slanted testimony—should not be witnesses for the court, chosen and screened for competence and objectivity. Or why most of the questioning of witnesses should not be the function of the judge, with the lawyers only afterwards permitted a limited right of cross-examination.

Finally, there is nothing in the Constitution to prevent limiting criminal appeals to one appeal confined (as in England) to review of the whole record, absent



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a showing of some gross irregularity at the trial or new evidence. Legislation or judicial ruling could accomplish these and other improvements drawn from the civil law tradition without starting down the futile road of trying to amend the Constitution. The Supreme Court, in an April 1991 decision, has already gone part of the way in limiting capital punishment appeals.

A Question of Guilt or Innocence

In the United States, the criminal justice process is now politicized in a way unknown in other civilized countries. Courts have become arenas of ideological conflict in which the overriding questions of guilt or innocence are eclipsed by disputes over procedure and constitutional safeguards.

There are of course powerful arguments against change. The most instinctive is the fear that any tampering with the structure of the criminal justice system threatens two of its essential features, certainty and predictability. Another weighty objection is that the American version of the adversarial system is uniquely compatible with our federal constitutional structure, the diversity of American society, and the vast dimensions of the country. It is also true that the civil law has no strict *habeas corpus* requirement, thus allowing detention before trial for as long as permitted by statute.

Certainly our federal system, with its reservation of the police power to the states and an independent judiciary at both state and federal levels, is at variance with the continental system of a centralized criminal justice system, uniform criminal code, and a career civil service judiciary with investigative and quasi-prosecutorial functions. Our ethnic diversity, social mobility, and absence of uniform social values make a

“government of laws and not of men” under a written constitution essential to assure equality of treatment under the law.

Presumed Innocent

In contrast to the civil law tradition, where the accused is to some extent the prisoner of the process and great trust is vested in the state to winnow the innocent from the guilty, the adversarial system guarantees the U.S. citizen a presumption of innocence right up to the verdict and a chance to challenge the power of the state until the final appeal. Trial by “jury of his peers” satisfies American egalitarian instincts and distrust (often well-founded) of governmental authority. The right of defense counsel to take advantage of every legal artifice, and to base appeals on procedural irregularities and infringement of constitutional safeguards rather than on sufficiency of the evidence, provides the accused with alternative routes of escape not available in other systems.

But whether the American adversarial system best serves the interests of society is another matter. Before making a final judgment, the reader should first take note of the observation of Professor John Merryman of the Stanford University Law School, a leading comparative law scholar: if innocent, he would prefer to be tried by a civil law court, but if guilty, he would prefer to be tried by a common law court.

Given the sanctity of the Constitution, the legalism that pervades American society at every level, and the size and power of the American legal establishment, there is no possibility that this country would ever embrace the whole of the civil law system. But why not consider borrowing from it? Or at least streamlining our own system in accordance with the British model? ■

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UNIVERSAL APPEAL

Politically Viable Policies to Combat Poverty

T H E D A S K O C P O L

What to do about poverty is, once again, on the public agenda in the United States. After languishing during much of the 1980s, serious debate about poverty policy has revived. The task for policymakers has certainly gotten no easier. Not only must they devise policies that will solve the staggering social problems now faced by America's most impoverished people, they must formulate policies with deep and enduring political appeal. If the Reagan-era backlash against the War on Poverty has taught us anything, it is that poverty programs must have the lasting support of a solid majority of Americans.

The dilemma for policymakers is whether it is politically shrewder to husband scarce federal resources and attack poverty through programs targeted only at the people most in need or to try to generate widespread support for antipoverty efforts through a more ambitious social program inclusive of all Americans. Supporters of targeted programs argue that Americans are strongly opposed to increases in taxes. Those who wish to launch comprehensive social programs insist that while programs directed only at the poor may be less expensive, they cannot generate sustained political support.

At times the debate appears to be a standoff in which advocates of both sides can each explain cogently why the other's prescriptions will not adequately help the poor. As far as speculative arguments go, there certainly is a standoff. Yet a close look at the targeted programs that grew out of the War on Poverty and the relatively universal social security system—the nation's most effective antipoverty program—supports several conclusions. First, the targeted antipoverty efforts have been generally underfunded, demeaning, and politically unsustainable. Second, social security has been well funded and politically very successful. Third, and most important, although social

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ing within Universal-
ism," in Christopher
Jencks and Paul E.

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(Brookings, 1991).

security was not originally conceived as an antipoverty program, room has been made *within* it for extra benefits and services that disproportionately help less privileged people without stigmatizing them. How social security aids poorer elderly people within the framework of its universal benefits offers us a powerful lesson about what I call "targeting within universalism" and suggests a way to revitalize and redirect U.S. public social provision today.

The War on Poverty

During the administrations of John F. Kennedy and Lyndon Johnson, war was declared on poverty. Reformers dreamed of reeducating the poor to take advantage of economic opportunities, especially by reforming juvenile delinquents, giving children a head start and better schools, and offering job training to adults. The Johnson administration aimed to improve access to medical care for the nonelderly poor and the elderly in general. The Nixon administration witnessed large increases in transfers to the poor. Overall, according to Michael K. Brown, "federal expenditures for cash and in-kind transfers directly targeted to the poor almost tripled from the end of fiscal year 1969 through fiscal year 1974, with most of the increase not in cash assistance, but in programs such as food stamps, medicaid, housing subsidies, and student aid." Aid to families with dependent children was also expanded in these years as states eased eligibility rules in response to changing federal regulations and attempted to make clients eligible for more generous federally subsidized benefits linked to AFDC.

The War on Poverty indisputably helped many people. According to John Schwarz in *America's Hidden Success*, economic expansion between 1965 and 1972 lifted out of poverty perhaps only one-tenth of the 21.3 percent of Americans who were below the poverty line in 1965; government programs lifted more than half of the rest above the poverty line. But

strategies of the Kennedy, Johnson, and Nixon years failed to reduce poverty rates much among the nonelderly, and certainly failed to reverse such specifically worrisome trends as the increase in out-of-wedlock births and families sustained only by mothers. Antipoverty warriors can argue that not nearly enough was done or spent to end poverty or to reduce pathologies among the severely disadvantaged. But that is precisely the problem inherent in targeted programs. Inadequately funded as it was, the War on Poverty quickly generated political backlashes that ended possibilities for its continuation and improvement. During the 1970s, public opinion polls recorded decreasing support for government efforts to aid minorities and for public social spending, especially on service programs popularly identified with poor blacks.

The political situation was rooted in a split between the people who apparently benefited most from the changes in social policy in the 1960s and early 1970s and the people who had to pay higher taxes during the 1970s and into the 1980s. Although many working class and middle class families surely gained from increases in social benefits to their elderly relatives, they perceived no gains to themselves from increased welfare transfers to the poor. Meanwhile, they faced rising financial burdens attributable to higher bites from payroll taxes, the effect of inflation and bracket creep on federal income taxes, and increases in state and local taxes.

Little wonder that many working class and middle class Americans found Ronald Reagan's tax cuts and his generalized attacks on government's social role appealing. Although Reagan's efforts were not as successful as is often supposed, the political and intellectual discourse of the 1980s expressed and reinforced widespread hostility toward "throwing money" at poor people.

Social Security

In sharp contrast, America's most effective program for lifting people out of poverty—social security—has seen no such backlash. Of course, in its early years U.S. social insurance was far from an antipoverty policy. For the first three decades, the originators and administrators of social security concentrated on building mainstream support and extending the scope of the program. Even though beneficiaries reaped windfalls because they had not paid taxes for long, and even though tax increases for social security were repeatedly deferred while benefits were increased, the administrators deliberately portrayed the system as a set of individual "accounts" into which "contributors" paid taxes to build up "earned" benefits. Social security, it was made clear, was very different from public assistance.

Step by step, new categories of beneficiaries and taxpayers were brought into the system, until by the early 1970s it encompassed more than 90 percent of the labor force. New types of benefits were added to the core of retirement insurance, partially filling the vacuum left by the absence of national health insurance. What was launched as old age insurance in 1935 became old age and survivors' insurance in 1939 and became old age, survivors', and disability insurance in

1956. Finally, Congress added medicare to the system in 1965.

Social security has always favored the stably employed and the middle class. Benefits are pegged to the earnings of pensioners during their working lives. And payroll taxes are regressive because they are set at a flat rate and are not collected at all on earnings above an income ceiling.

Nevertheless, from the start the system gave proportionately higher retirement benefits to lower-income workers. More important, once social security was established as virtually universal for working Americans, its administrators worked to make benefits higher for everyone, and relatively better for the less privileged, so that benefits could approximate a sufficient retirement income. During the 1960s and 1970s social security's promoters followed a strategy that Hugh Heclo has called "helping the poor without talking about them." Amidst the fuss about the War on Poverty, plans for medicare were quietly brought to fruition. Congress enacted social security benefit increases in 1967, 1969, 1971, and 1972. All told, benefits, adjusted for inflation, rose 23 percent. As Martha Derthick has pointed out, in 1975 benefits were equivalent to 67 percent of wages for a married man earning average wages and 92 percent of wages for a married man earning the federal minimum wage—up from 50 percent and 67 percent, respectively, a decade earlier.

Although nonelderly families benefit from disability and survivors' insurance, the most significant anti-poverty effects of social security are from retirement benefits and medicare, which explains why elderly families have benefited disproportionately. As Gary Burtless notes, the poverty rate for America's elderly fell from 35 percent in 1959 to 14 percent in 1983, while the rate for nonelderly fell only from 22 percent to 15 percent. For older Americans who might otherwise be impoverished, the Social Security Administration's practice of targeting within universalism has clearly worked well over the past quarter century.

The gains achieved for social security programs during the 1960s and early 1970s proved durable even in the face of Reagan administration onslaughts against social spending. Although public support for welfare declined sharply during the 1970s, some 95 percent or more of people polled continued to agree that "the government spends too little or about the right amount" on the elderly, despite substantial payroll taxes for social security. Talk of a "crisis" in social security led to a few adjustments, then died away. When the first Reagan administration discussed cuts in the program, it faced immediate public resistance and soon backed down (except that it continued for a time to use administrative regulations to cut people from the disability rolls). Targeted public assistance programs for low-income people accounted for less than 18 percent of federal social spending, yet took the brunt of the first Reagan administration's efforts to cut domestic spending. Impoverished mothers and children saw their benefits cut, but the elderly clients of social insurance, including those who would otherwise have been poor, preserved their improved economic standing.

Building on the Social Security Model

The lesson is clear. Those who would do more now to help the poor through public social policies should not try to devise new programs narrowly focused on low-income people or the urban poor. They should quit trying to reform or expand aid to families with dependent children and other means-tested public assistance programs. Instead, they should work toward replacing welfare with new policies that could address the needs of less privileged Americans along with those of the middle class and the stable working class. They should put together new policies that speak with a consistent moral voice to all Americans, whether as recipients or as taxpayers, reinforcing rather than undermining fundamental values such as rewards for work, opportunities for individual betterment, and responsibility for the care of children and other vulnerable people.

It may not be possible to create, or find the money for, a comprehensive new social program overnight. What matters most is to conceive a structure that, like social security, is rooted in deeply and broadly held values and that can extend its embrace to poor Americans. Even if new measures start small and give significant proportions of their benefits to families who seem less needy than the most desperately poor, advocates for the poor should realize that, before long, such measures could create new opportunities for more targeted efforts. In contrast, measures that start small and are narrowly focused may either lose support or (even if they are popular, like Head Start) simply never get the full resources they need to meet crying social needs.

Family Security

To supplement social security programs for the elderly, the United States could develop what might be called a family security program available to all children and working-age citizens. The new program would include child support assurance for all single custodial parents, parental leave and child-care assistance for all working families, job training and relocation assistance for displaced workers and new entrants to the labor market, and universal health benefits.

Child support assurance would establish nationwide guidelines requiring all absent parents (most of whom are fathers) to pay proportions of their wages as child support. As a substitute for the current haphazard system of judicially awarded child support, payments would be automatically fixed and collected through wage withholding, exactly as income and social security taxes are now. Checks to all custodial parents (mostly mothers) would come from the government and would nearly equal the amounts collected from absent parents. When support payments could not be collected or when they fell below a minimum benefit needed to raise children, the custodial parent would receive a minimum payment.

Such a program would express the nation's interest in helping single parents with the socially crucial work of raising the approximately half of American children who are now growing up in such families. It would address pressing social problems that cut across class and racial lines, since half of all marriages now end in

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divorce and only half of all divorced mothers receive child support (separated and never-married mothers fare even worse). Because the government would be sending checks to middle class, upper class, and poor women alike, the program would, as David Ellwood describes it, involve “no stigma, no failure, and no isolation.” At the same time, an adequate minimum benefit could do much to help needy mothers and, in contrast to welfare payments, would not disappear as soon as the mother went to work.

Both dual-parent and single-parent families also need help with the growing challenges of balancing their parental responsibilities with work outside the home. More and more married women, including mothers of young children, are working outside the home, yet current public policies do remarkably little by international standards to buffer families from the challenges of childbirth or adoption or to help them find and finance adequate child care. Various policies could address these problems for all families. At a minimum it surely makes sense to move toward paid parental leave for families of newborns or new adoptees, perhaps with legally mandated unpaid leave, including guaranteed reinstatement, as a first step.

Another goal should be to deliver more income through public means to all families who must combine work and parental responsibilities, with larger benefits (proportionately and absolutely) for the neediest families. The dependent exemptions now in the U.S. tax code are widely acknowledged to provide inadequate help to families with children. All families with children could be given larger, refundable tax credits, which would benefit alike families with two workers and those with full-time homemakers. Or public benefits could be tied much more directly to women’s labor force participation by offering refundable tax credits to families who have to purchase child care while a single parent or both parents work.

Looking for Jobs in All the Wrong Places

Help for parents raising children is one part of an overall family security program. The other part must be help for all adults who are looking for jobs. As William Julius Wilson and his collaborators have argued, poor job prospects for unskilled young black men make it hard for them to marry and have families, especially in inner cities. The present welfare system also unnecessarily traps many single mothers into making a stark choice between unskilled paid work at very low wages or welfare benefits that are available only to mothers who do not work. The existing system rarely helps them gain new skills, nor does it urge or help them to relocate, if necessary, to take advantage of decent jobs and housing.

A new national labor market system would provide help and incentives to all workers—whether low-income, unskilled single mothers or divorced former homemakers or skilled workers who have been displaced—within the same broad, nonstigmatized rubric. It could identify jobs and areas of the country where new workers are needed. It should provide transitional unemployment benefits and perhaps housing subsidies, if necessary, to help workers and their families relocate. And it could train or retrain people

to help match their skills to available jobs. In addition to the concrete benefits such a program would provide, it would also reinforce the strong American preference for working to support one's self and one's family, rather than being on the dole.

Some analysts believe that a new labor market system should also guarantee public jobs at the minimum wage as a last resort. But this might stigmatize the system as a make-work program, whereas emphasizing training and relocation would make the policies appealing to the working class and middle class public. If more jobs are needed in the end than can be generated through private and existing public labor markets, then other kinds of federal and state policies, such as measures to develop infrastructure, might be planned to create new jobs for workers in training. Furthermore, a higher earned income tax credit for low-wage workers might indirectly make more self-supporting jobs available to newly trained workers. Although this is a targeted measure, it qualifies as targeting within universalism because it arranges subsidies through the income tax system in which all workers participate.

Finally, more universally available health benefits are essential. The present patchwork system of health insurance discourages labor mobility and job redefinitions within industries and workplaces, because medical insurance for many employees and their dependents is tied to certain professional and unionized jobs, and coverage is not available through other jobs (or through part-time work that makes sense for many parents). Likewise, the present system provides medical insurance to welfare recipients (and sometimes to people with incomes slightly above a legally defined poverty line), but leaves many working people, especially low-wage workers, without coverage. This situation discourages recipients from moving off welfare and arouses taxpayer resistance to improving public provision for the health care of impoverished families. The present uneven system of publicly provided or tax-subsidized health benefits only for the elderly, the very poor, and the unionized should be replaced either with Canadian-style universal health insurance or with publicly mandated private insurance or contributory publicly funded health benefits.

But Can We Afford It?

For a decade now the federal budget deficit has precluded discussion of new policies that threaten to cost a lot. But some of the programs I have discussed could save or generate considerable revenue, as well as spend it. Child support assurance would be financed in large part by wage withholding from absent parents, and the minimum benefit would make it possible to phase out much of aid to families with dependent children. The system of job training would replace unemployment insurance. New child support and labor market policies would put people to work and thereby generate new tax revenues.

Nevertheless, a family security program of the sort outlined, especially the provisions for health insurance and child-care assistance, would require new funding from the federal government. The lesson of the social security system is that Americans will accept taxes that

they perceive as contributions toward public programs in which there is a direct stake for their families, not just for "the poor," and that they perceive as strengthening traditional moral values. Perhaps the introduction of new programs on a modest scale could be accompanied by a family security payroll tax, collected up to a considerably higher wage base than social security taxes are now to avoid some of the worst regressive features. In any event, new universal programs and new sources of revenue, to be collected from virtually the entire population, not just small subgroups (as with the unsuccessful medicare catastrophic illness surcharge), should be discussed together. If this is done, there is reason for optimism about the willingness of Americans to accept new public policies to address family needs that are widely felt.

Why Help Those Who Can Help Themselves?

Can America's poor really be helped by the program I have outlined? Wouldn't the principal beneficiaries be the middle and working classes, along with the most privileged and least troubled of the poor, leaving behind many of the extremely disadvantaged, disproportionately people of color, who require intensive services to break out of cycles of social pathology and despair? The blunt answer is probably yes—at first. But such a program would offer the most help, the soonest, to disadvantaged adults who are willing to work and care responsibly for their children. Once genuinely new and nonstigmatizing incentives, social supports, and ways of providing job opportunities were solidly in place, the example of hardworking people taking advantage of new programs and making better lives for themselves might offer hope where now there is none. The example of lives made better *through* work and family responsibility would facilitate the moral reintegration of poor people into the mainstream of national life.

Universal policies would also change the attitudes of more privileged Americans, which returns us to the bedrock matter of broad and sustainable political support for antipoverty policies. Just as social security has done, new family security policies, once established, would probably nourish broad political alliances prepared to support extensions of benefits and willing to accept redistributions toward the less privileged at the same time. If and when new public social policies begin to help American families from all social classes and all racial and ethnic groups to meet contingencies of ill health, job loss, and the challenges of balancing paid work and parental responsibilities, then a "kinder and gentler" nation might actually emerge.

With their own values and needs recognized through a revitalized public sector, more middle-class American citizens would be prepared to go the extra mile for especially needy minorities. As experience has taught us, targeted programs for the poor alone do not work, however well-intentioned they might be. Targeting through universalism recognizes the reality that only through true political community will we create a more comprehensive system of social security that reaches out to embrace those who now seem so hopelessly apart. ■

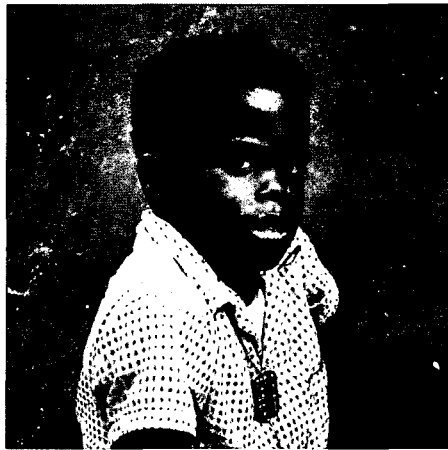
RELIEVING POVERTY

Theda Skocpol argues for abandoning targeted antipoverty efforts and focusing solely on universal programs. She contends that programs limited to the poor have such a weak political base that they are inevitably cut or eliminated or else remain modest in scope.

No one doubts that universal programs have broader, stronger constituencies. But to conclude that targeted programs are doomed to yield disappointing results and that universal approaches are always preferable is unwarranted. The recent history of social programs demonstrates that many targeted programs are considerably stronger politically than Skocpol suggests.

Furthermore, the nation is unlikely to provide the resources for an antipoverty agenda composed entirely of universal programs. As a result, identifying effective targeted approaches that can attract political support is crucial to charting an antipoverty strategy for the 1990s. Such a strategy will need to include a mix of universal and targeted programs.

Much of Skocpol's argument rests upon a comparison of social security's political strength with the relative weakness of aid to families with dependent children and Great Society programs aimed primarily at poor families with children. This is an inappropriate comparison, however, since the differing political strengths of these programs depend on far more than whether they are universal or targeted. Social security is viewed by the public as an *earned* benefit for elderly people not expected to work. Such a program will always be stronger than programs for working-age families who have *not* earned their benefits and often are not even in the labor force. Comparing an entitlement such as social security with a nonentitlement program such as Head Start also is inappropriate; entitlements generally fare better politically. Among major nonentitlement programs, the two that grew most in the 1980s were the nutrition program for women, infants, and small children (WIC)



and Head Start, both targeted programs.

Among the entitlements, the cuts in the early Reagan years did hit targeted programs hardest, but most of these programs were subsequently expanded. The principal medicaid cuts enacted in 1981 expired after 1984. Since then, medicaid coverage has been substantially enlarged and will ultimately include all poor children under age 19 and most elderly and disabled poor people. Moreover, some of these medicaid expansions were financed through reductions in medicare, a universal program.

The food stamp program was cut in 1981 and 1982, but expanded in 1985, 1987, and 1988, when some of the initial reductions were repealed and basic benefit levels were raised to their highest level since the program began. Also, while the universal social security program was cut modestly in 1981 and 1983, the targeted welfare program for the elderly poor—Supplementary Security Income—was expanded. And after 1982, no means-tested entitlement was cut further.

Skocpol's argument seems even more questionable in view of last fall's budget law, which included large expansions in three targeted programs. As already noted, medicaid coverage grew significantly. The earned income credit was expanded \$18 billion over five years. And two new child care programs were established, both tar-

geted on low- and moderate-income working families.

Furthermore, of the three entitlement programs that were cut most deeply in the 1980s—unemployment insurance, disability insurance, and AFDC—two are universal programs. Following retrenchment in the UI program, the proportion of jobless workers receiving UI benefits has set record lows in five of the past seven years. The social security disability program also contracted. As the criteria for getting disability benefits were made more restrictive, the number of beneficiaries dropped from 4.9 million in 1978 to 4.3 million in 1990, while the incidence of new disability awards fell even more sharply. Being universal and part of social security did not insulate disability insurance from attack.

The historical lessons thus go beyond a simple conclusion that universal programs have stronger constituencies than targeted programs. A more interesting question is why some targeted programs were expanded even during the Reagan years, while other targeted programs—and some universal programs—fared less well.

The three targeted programs expanded most in recent years—the earned income credit, medicaid, and child care programs—share two characteristics. In each case, the expansions were targeted on working families not on welfare. And in each case, working families with moderate incomes benefited from the expansion, along with those at lower income levels.

The earned income credit now covers working families with incomes up to \$21,000 a year. Recent medicaid expansions have extended health insurance to pregnant women and children in low- and moderate-income working families; the medicaid income limit for pregnant women and young children now ranges from \$17,800 to \$24,800 for a family of four in all states. Under the new child care programs, eligibility limits will run as high as \$30,000.

These targeted programs have managed

An Alternative View

By Robert Greenstein

largely to avoid the political pitfalls that arise when economically struggling working class families with incomes just above the poverty line have to pay taxes that go for programs limited to people with incomes below the poverty line. Some of the groups among whom welfare backlash has traditionally been thought strongest are beneficiaries of the earned income credit, the expansion in medicaid coverage, the child care programs, and WIC.

Including families in these income ranges also helps these programs avoid an image of being primarily for minorities. While AFDC is popularly perceived as being primarily for black welfare mothers, programs like the earned income credit and WIC are regarded differently. They are better able to meet William Julius Wilson's call for policies the public does not view as race-specific. They do this within a targeted framework.

In addition, these programs reflect the values of encouraging work and caring for children. They demonstrate that social programs stressing these values can be targeted in nature.

There are other reasons why some targeted programs fare better politically than others. Whether a benefit is linked to work and perceived as earned—or whether it is seen as welfare for able-bodied adults—is clearly important. (The severe weakness Skocpol ascribes to targeted programs is most accurately ascribed to cash welfare programs for people who are not elderly or severely disabled and who do not work or work very little.)

The group of poor people covered by a program is also significant. Programs targeted on nonworking, nonelderly adults, like AFDC and state and local general assistance programs, tend to be much weaker politically than those that encompass low-income elderly people or working families, as the food stamp program does.

The food stamp program has other sources of strength as well. Its benefits are federally prescribed and fully federally fin-

anced, and are provided in kind rather than in cash. These factors, along with its inclusion of the elderly, seem to bolster the program. While AFDC benefits for families with no other income are now 40 percent lower in purchasing power in the median state than they were in 1970, food stamp benefits in the median state are slightly higher than two decades ago.

The importance of full federal funding is also seen in SSI benefit trends. The basic federal SSI benefit is slightly higher now than when the program started in 1974; state supplemental benefits are sharply lower.

Entitlement status also helps, as does whether a program is perceived as effective. Head Start and WIC have been expanded largely because they are considered effective. By contrast, the public service employment and job training programs of the Comprehensive Employment and Training Act were viewed in the early 1980s as yielding disappointing results. They were cut sharply or terminated.

The Keys to Political Success

In short, targeted programs tend to fare better when they are not viewed as welfare (especially cash welfare), when they operate outside the welfare system (for example, earned income credits are delivered through the tax system), when they are viewed as providing benefits that are earned or otherwise linked to work, when the low-income constituency being served is broad (by virtue of including families in the near-poor or moderate-income range, or the elderly, or both), when the program is an entitlement with federally prescribed and funded benefit levels, and when it is regarded as effective.

Significantly reducing poverty is likely to require a mixture of such targeted approaches along with universal ones. Such a strategy would include initiatives Skocpol recommends, like universal access to health care, assured child support, and conversion of the personal exemption for children into

a refundable tax credit. It could also include carefully designed targeted approaches such as increased housing and child care assistance for low-and moderate-income working families, and increased funding for Head Start, WIC, childhood immunization, prenatal health care services, and other effective early-intervention programs. (A stronger unemployment insurance system and somewhat higher minimum wage would also help.)

These programs and policies could be supplemented by locally administered, intensive services targeted on people facing serious barriers to self-sufficiency. Without such services, some families and individuals may never enter the mainstream economy.

Fiscal considerations and program experience suggest that such services need to be targeted. As Isabel Sawhill has observed, "If there is one lesson we have learned from all the evaluations and research that have been conducted since the War on Poverty began, it is that[service] programs that provide limited benefits to many people, although politically popular, are not effective in responding to the problems of the most seriously disadvantaged." That is why the Job Training Partnership Act is being redesigned to concentrate more heavily on disadvantaged youth and others with serious employment problems.

In short, some of Skocpol's specific proposals are excellent, but her broad conclusions that targeted program "do not work"—and that those seeking to assist the poor should quit trying to reform or expand means-tested programs—should not be heeded. ■

Robert Greenstein is founder and director of the Center on Budget and Policy Priorities. This article is adapted from "Universal and Targeted Approaches to Relieving Poverty" in Christopher Jencks and Paul E. Peterson, eds., The Urban Underclass (Brookings, 1991).

The Reluctant Giant

WILL JAPAN TAKE
ITS ROLE ON THE
WORLD STAGE?

Robert Z.
Lawrence

Japan is, by any standard, a preeminent economic power. In 1989, per capita income in Japan was the world's highest. The Japanese economy is second in size only to that of the United States. In numerous technological fields Japanese firms are global leaders. Net foreign assets make Japan the world's largest net creditor country. Domestic investment makes Japan the world largest investor. Yet Japan's role in world politics does not measure up to its economic stature. Some would say that Japan is an economic giant but a political pygmy.

Japan's failure to play a leading role in world affairs could have serious implications for the world economy. The catastrophic performance of the world economy in the 1930s can in part be ascribed to the failure of the emerging power, the United States, to take over the leadership role being abandoned by the United Kingdom. Likewise, in the post-Cold War era, the United States is seriously constrained in exercising its leadership role by weak domestic economic performance. America today, according to President Bush, has "the will but not the wallet."

But the Japanese remain reticent about stepping firmly onto the global stage. And, to be fair, there are important political reasons for their reluctance. First of all, the disastrous militarism of the Second World War appears to have left the Japanese people deeply skeptical about playing a large global role. Second, the policies of the past three decades, in which Japan has concentrated on domestic economic development, have enjoyed tremendous success. And finally, Japan is home to a complex domestic political system that operates on consensus. The result is that certain policies that hurt important interests frequently can be implemented only when external pressure is present. That makes it difficult for Japanese leaders to take decisive actions—a precondition for an effective global role. Indeed, the inhibitions on decisive action were painfully evident in Japanese behavior during the Persian Gulf crisis.

But if Japan itself seems reluctant to take on a global leadership role, its chief economic competitors also seem resistant to Japanese efforts to extend its reach even on the economic front. In particular, as Japan has increased its technological proficiency, its products have faced obstacles at every turn. In the late 1950s restraints were placed, first by the United States and then by other countries as well, on Japanese textiles. In the late 1960s, the Japanese faced resistance to their steel exports. In the

1970s, it was televisions; in the 1980s, automobiles and semiconductors. The surge in direct foreign investment into the United States in the late 1980s has likewise met with suspicion.

Recently the Japanese Ministry of Finance has joined those arguing that the world is moving into an era in which savings will be in short supply globally. Demand for capital for the reconstruction of Eastern Europe and the Soviet Union, in addition to the needs in developing countries and in the Persian Gulf, would make large surpluses in the Japanese current account valuable to the rest of the world. In fact, a large Japanese current account could be viewed not as an imbalance, but rather as a way to bring global saving in line with global investment opportunities. But channeling Japanese savings to the world requires not simply flows of capital, but also the counterpart flows of goods and services. And it is questionable whether Japan's major trading partners would tolerate the necessary increase in Japan's exports to support this otherwise beneficial activity.

Yet judged by historical, and even some contemporary, standards, neither the Japanese current account nor the volume of manufactured goods exported from Japan is particularly large. At its peak, the Japanese current account surplus in 1986 amounted to just 4.4 percent of Japan's GNP. By 1989 it had declined to 2.0 percent of GNP. By comparison, the West German current account surplus was 4.0 percent of GNP in 1986 and has actually increased since then. Similarly, in the 19th century, Great Britain ran a current account surplus that averaged 4.5 percent of GNP for more than four decades. In absolute terms, West German manufactured goods exports valued at \$294 billion in 1988 were far larger than those of Japan, at only \$257 billion. And British investment in the United States remains larger than that of Japan. So why do Japanese exports and investments meet with such a different response?

Some attribute these problems to foreign racism; others, to "sour grapes" and envy of Japanese success. Perhaps. But there is more to it than that. In my view the answer is that Japan does not have the international political relationships traditionally required to support international economic leadership.

Germany's economic strength depends in large part on the political alliance it has forged with other European nations in the European Community. Within that institutional setting, which accepts the free flow of German products, much of the

German trade surplus is recorded with its European trading partners. During the 19th century, Great Britain exercised its economic leadership in the context of an empire backed up by the military power of its navy. And in the postwar period, of course, the United States has been a nuclear superpower, and the worldwide acceptance of American firms and products has reflected in part the military and political role played by the United States as the leader of the free world. Japan, on the other hand, has no such formal political alliances and no capacity to project power.

The Political Payoff to Open Markets

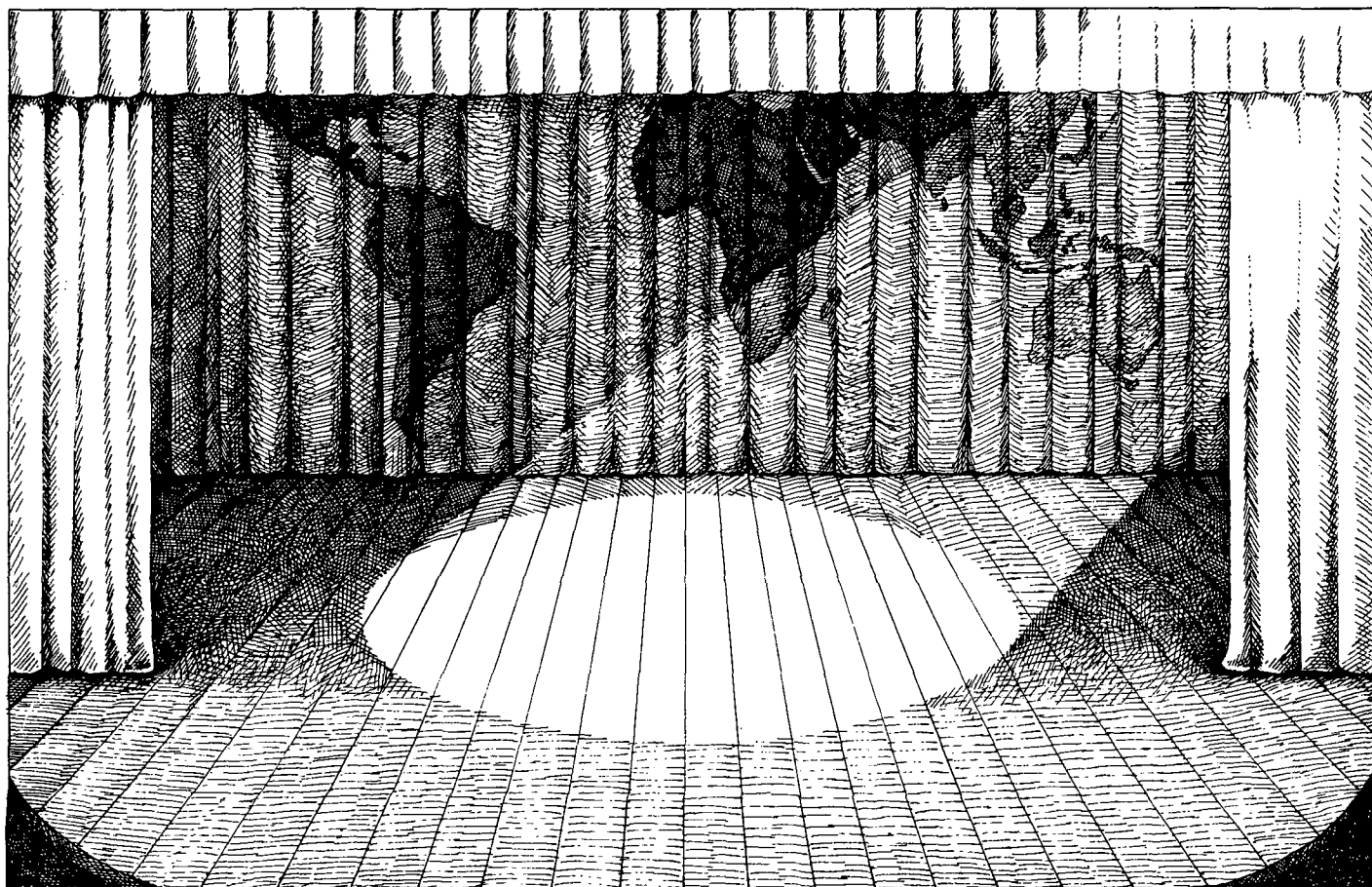
But while their political alliances and military strength clearly facilitated the strong international economic performance of Germany, the United Kingdom, and the United States, each of those countries was also able to use trade policy to reinforce the favorable political reception accorded it. While Great Britain ran large current account surpluses for more than 50 years, it also offered a relatively open domestic market. Indeed, during those same 50 years, the British merchandise balance was invariably in deficit. Foreign producers thus had a considerable interest in main-

taining trading relationships with Britain.

In fact, the British were keenly aware of the political and economic benefits of an open domestic market. It was not a coincidence that between 1842 and 1860, a period of consistently high current account surpluses, Britain unilaterally reduced the tariffs protecting its domestic market. In 1845 Britain abolished the import tariff on raw cotton; the next year it repealed the Corn Laws, allowing access to its lucrative grain market. Shortly thereafter western agricultural interests in the United States joined with southern farmers against more protectionist northern interests in passing the Walker Tariff liberalization. Scott James and David Lake note that in 1844 the London *Economist* reported, "We open our ports to the cotton and rice of the south, and we there find every disposition to appreciate the advantages of our superior manufactures."

The openness of the German market also plays an important role in encouraging the acceptance of German exports. As reported in table 1, the German surplus in trade in manufactured goods is a far larger share of GNP than the Japanese (in 1988, 9.4 percent, as against 6.3 percent). German exports of manufactured goods are greater

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than Japan's. But Germany imports manufactured goods on a scale far exceeding Japan. In 1988 manufactured imports amounted to 14.9 percent of German GNP, but only 3.2 percent of Japanese GNP.

In the 19th century, of course, most trade reflected specialization along the traditional lines of comparative advantage—ships carrying agricultural products from the southern United States crossed paths in the Atlantic with ships hauling manufactured goods from England. In the postwar 20th century, trade between industries based in different countries has grown strikingly. The political implications of such trade in keeping markets open are likely to be even more powerful than traditional trade.

Fending off Trade Protection

Germany, for example, has not only an open domestic market, but also relatively extensive trade with other countries in goods that it makes and exports itself. In 1988 West Germany exported \$45 billion worth of chemicals—more than any other nation in the world. But it also imported around \$25 billion worth, or roughly the same as the United States did, though Germany's economy is only one-fourth as large. This trade pattern gives Germany a strong edge on the international scene. If a particular German chemical company becomes highly competitive in exporting to the United States, some American com-

petitors might consider lobbying for trade protection. But other U.S. companies, even within the chemical industry, will oppose protection because they benefit from exporting to Germany. In the absence of an industrywide consensus, there would simply be no pressure for trade protection.

Japan, by contrast, has extraordinarily few such intra-industry imports. In 1988, the value of Japanese exports of motor vehicles was \$48.8 billion—similar to the value of German chemical exports. But Japanese imports of cars were a paltry \$3 billion. Simply put, Japan has too few foreign hostages. When American interests oppose the import of a particular Japanese product, few other U.S. interests will counteract them in order to defend their Japanese sales.

Relations between Germany and other major industrial countries have also been cemented by the extensive participation by foreign-owned companies in the German economy. By contrast, although much is made of the foreign success stories in Japan, foreign-owned firms account for an unusually small share of overall sales in Japan. In 1986 foreign-owned firms accounted for 1 percent of total Japanese sales—compared with 10 percent in the United States and 18 percent in West Germany.

The Political Side to Investing Abroad

Investing abroad could, of course, help create a more favorable reception for Japanese products. It is important, however, to distinguish between investments in new plants ("greenfield") and those in takeovers. Direct takeovers have the least favorable political effects because while they bring in new capital and management, they do not necessarily create new employment opportunities. The *way* firms invest abroad is also important. The more they incorporate powerful interests in the host country in their activities, the higher the political payoff will be. Japanese joint ventures with U.S. auto companies provide particular political benefits, for example, when they hire members of the United Auto Workers. Local content also matters. Using local, rather than foreign, suppliers to provide parts causes local cooperation and agreeableness to flourish. Japanese firms, however, are accused of having a stronger national preference than do their American and European-owned counterparts and of purchasing a disproportionate quantity of products from Japanese suppliers.

Yet another way to assess how well an international trading country is integrating its trading partners into its own activity is

Table 1. Merchandise Trade and Current Account Balance, Germany and Japan, 1986, 1988

PERCENT OF GNP

CATEGORY	GERMANY		JAPAN	
	1986	1988	1986	1988
MANUFACTURED GOODS				
Exports	24.2	24.4	10.4	9.5
Imports	14.2	14.9	2.2	3.2
Balance	10.0	9.4	8.2	6.3
OTHER MERCHANDISE				
Exports	2.9	2.4	0.3	0.3
Imports	7.1	5.8	4.2	3.8
Balance	-4.2	-3.4	-3.9	-3.5
TOTAL MERCHANDISE				
Balance	5.8	6.0	4.3	2.9
CURRENT ACCOUNT				
Balance	4.5	4.2	4.4	2.9

Sources: Japan Economic Institute Report, September 21, 1990, OECD Economic Surveys, Germany 1988/89.

the nationality of the firms that distribute foreign products within its borders. Using Department of Commerce surveys on trade between U.S. multinational corporations and their foreign affiliates and between foreign multinationals and their U.S. affiliates, we can put together the following picture. In 1988 trade within these multinational corporations accounted for 40.0 percent of U.S. exports to Europe, and 48.5 percent of U.S. imports from Europe, whereas such shipments accounted for 79.4 percent of U.S. imports from Japan and 57.2 percent of U.S. exports to Japan.

A striking feature of these numbers is the unusual degree to which Japanese multinational corporations dominate Japanese imports. In U.S. and European exports to each other, the exporting country's multinationals dominate sales. In 1988 shipments of U.S. corporations to affiliates in Europe accounted for 31.8 percent of U.S. exports to Europe while shipments by European corporations to affiliates in the United States accounted for 34.8 percent of European Community exports to the United States. Similarly, the lion's share of Japanese exports to the United States went from Japanese corporations to U.S. subsidiaries—their share was 69.0 percent of all U.S. imports from Japan.

But U.S. multinationals do *not* dominate U.S. exports to Japan. In 1988 Japanese affiliates in the United States shipped 36.4 percent of all U.S. exports to Japan back to their Japanese parents, while U.S. parent companies shipped to their Japanese subsidiaries only 16.8 percent of all Japanese imports from the United States.

These data suggest that by and large American products sold in Japan are not sold by U.S. firms. More typically, U.S. exports to Japan are shipped from the United States by Japanese firms (usually trading companies). Even when they are selling in Japan, therefore, American firms do not contribute as much value-added as they do when selling to other countries. American firms are thus likely to see Japan as a less important market.

In sum, instead of using business and trade practices to increase political influence, as did Great Britain in the 19th century, and as Germany and the United States do today, Japan is doing its international business in a way that reduces its political influence. Both the volume of Japanese imports of manufactured goods and the share of intra-industry trade are low. Japanese firms control the distribution of imports to an unusually high degree, and foreign firms play an unusually small role in the Japanese economy and as sup-

pliers to Japanese firms located abroad.

Pat Choate's book *Agents of Influence* has recently painted a vivid picture of high-priced lobbyists prowling Capitol Hill and assorted government agencies on behalf of Japanese interests. Some interpret the Japanese lobbying effort as a serious threat to U.S. sovereignty. I would argue that the lobbyists actually reflect the vulnerability of Japan's political position.

The Domestic Politics of Open Trade

Thus far I have concentrated on showing how the structure of Japanese economic relations fails to generate *international* political support and thus contributes to Japan's failure to become a major global power. But another reason for Japan's attenuated political role is that its economic relations do not lead to *domestic* support for a more active role in world political affairs.

Evaluated at current exchange rates, per capita incomes in Japan are 20 percent higher than those in the United States. But the purchasing power of that income is 30 percent *lower* than in the United States. Japanese consumers lag far behind Americans and Germans in their living standards. They do not *feel* wealthy and are thus less inclined to support major government spending abroad.

A big reason for the Japanese consumer's low buying power is trade protection. To be sure, land is relatively scarce in Japan, and thus even under the best of circumstances we would expect housing in Japan to be expensive. But trade protection—in particular, the use of land for growing rice—and other regulatory measures make land relatively more expensive than it should be. More generally, however, there is considerable evidence that foreign goods are unusually expensive when sold in Japan. A survey jointly conducted by Japan's Ministry of International Trade and Industry (MITI) and the U.S. Department of Commerce found that U.S. products were typically 40 percent more expensive in Japan than in the United States. Protections both formal and informal raise the prices of imported goods, and thus Japanese consumers simply are not afforded the opportunities to buy foreign products that their yen earnings ought to command. The key to higher Japanese living standards is opening Japanese markets more fully.

In sum, if Japan is to become a global power, it must first open its markets. Both at home and abroad, open markets will generate the political support necessary for the economic giant to take the world political role that beckons. ■

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Looking Backward: 2001 — 1991

The History of the Health Care Financing and Reform Act of 1998

HENRY J. AARON

The start of the new millennium is an appropriate time to look back at the enactment of one of the twentieth century's most important pieces of social legislation, the Health Care Financing and Reform Act of 1998. This statute, which will shape U.S. health care policy for much of the 21st century, promises to achieve two long-sought but elusive goals—assuring access to health care for all Americans and controlling explosively rising health care costs.

The wisdom of hindsight makes apparent that legislation much like this landmark act had been inevitable for many years. But as recently as a decade ago, close students of the U.S. health care system were broadly divided on the direction that reforms should or would take. The crisis of the mid-1990s overwhelmed the rather desultory debate of the early 1990s and made health care financing reform the central issue in the 1996 presidential campaign. Soon after the election the new president proposed specific reforms, and the Health Care Financing and Reform Act of 1998 became law.

A review of how the health care financing debate exploded into the forefront of American politics and the nature of the reforms enacted in 1998 illuminates the health care challenges facing the United States in the year 2001 and beyond. For although the new law provides the building blocks of a health care financing system that will finally allow policymakers to deal with the heretofore intractable problems of excessive health care costs and the ever-expanding pool of unin-

sured Americans, actually building that system will require our country to confront choices it has never faced before. Some would even say that the hard work remains ahead.

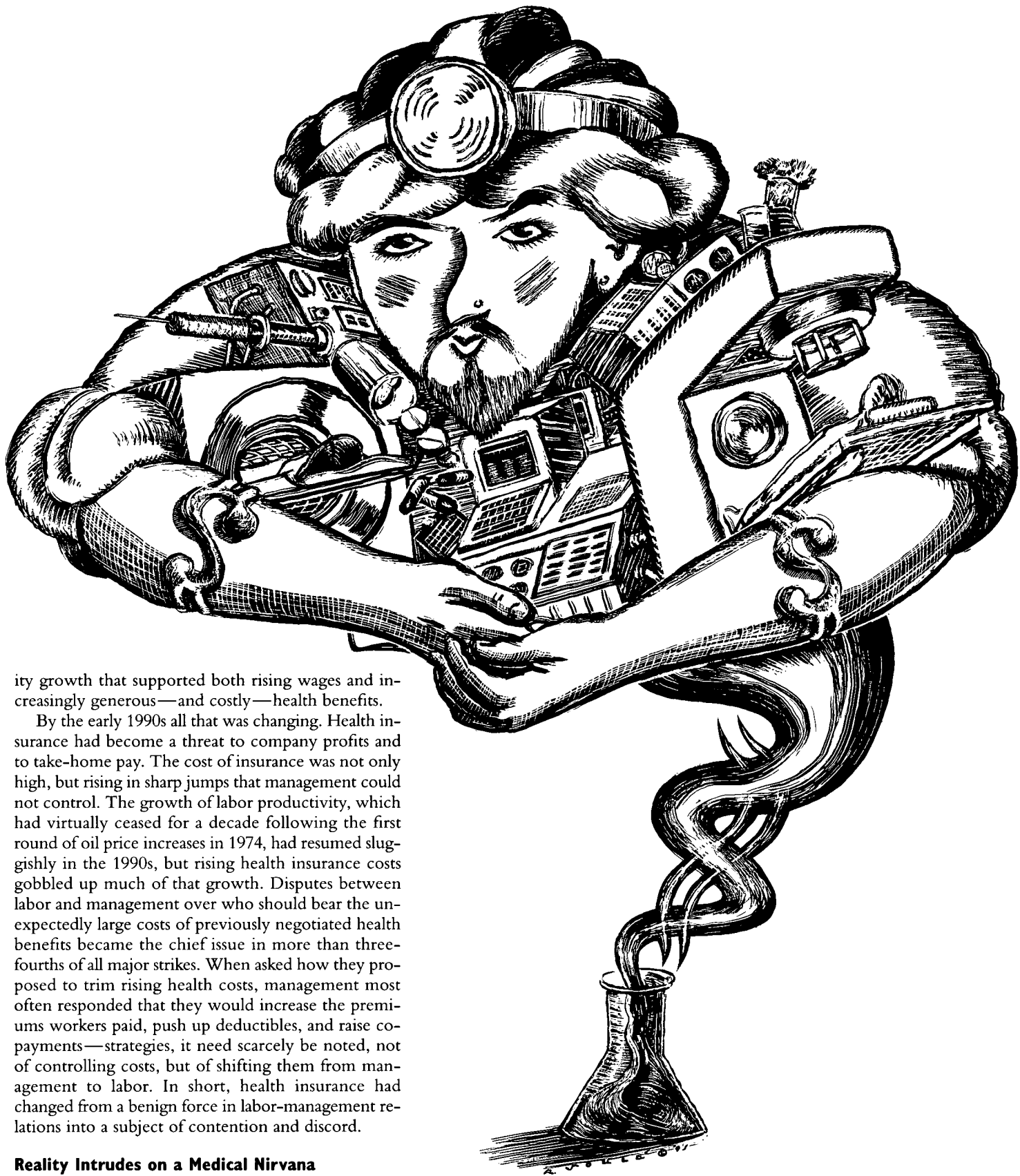
Early Signs of Change

Every durable political or economic institution in a democracy must serve the interests of the influential groups it affects. If important stakeholders are poorly served, they press for change, and sooner or later they get it. Looking backward to the early 1990s, one sees abundant signs that support for the way the United States paid for health care was eroding.

All big stakeholders had been well served by the financing system during the 1970s and 1980s. Although some had sought marginal improvements, a large majority supported the status quo over any alternative. But high and sharply rising costs set forces in motion that undermined that support.

During the 1970s employer-sponsored health insurance, which served most of the nonelderly population, appealed to both business and labor. Employers saw it as a fringe benefit of modest cost that promoted loyalty to the company. Workers knew that if they had to buy insurance on their own, they would lose the tax advantages of employer-financed plans and the discounts provided to groups. Leaders of organized labor claimed that generous health benefits along with continuously rising real wages were prizes won by collective bargaining. In reality, it had been rapid productiv-

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(Brookings, 1991).



ity growth that supported both rising wages and increasingly generous—and costly—health benefits.

By the early 1990s all that was changing. Health insurance had become a threat to company profits and to take-home pay. The cost of insurance was not only high, but rising in sharp jumps that management could not control. The growth of labor productivity, which had virtually ceased for a decade following the first round of oil price increases in 1974, had resumed sluggishly in the 1990s, but rising health insurance costs gobbled up much of that growth. Disputes between labor and management over who should bear the unexpectedly large costs of previously negotiated health benefits became the chief issue in more than three-fourths of all major strikes. When asked how they proposed to trim rising health costs, management most often responded that they would increase the premiums workers paid, push up deductibles, and raise co-payments—strategies, it need scarcely be noted, not of controlling costs, but of shifting them from management to labor. In short, health insurance had changed from a benign force in labor-management relations into a subject of contention and discord.

Reality Intrudes on a Medical Nirvana

Though less dramatic, the shift in attitudes of U.S. physicians was quite striking. The American system of financing health care in the 1970s and early 1980s was a veritable physician's fantasy. Upon emerging from the best medical schools in the world, trained to use

the latest and most costly equipment, drugs, and medical techniques, doctors confronted a system of payment that gave them virtually absolute clinical freedom and paid them more, both absolutely and in relation to average worker compensation, than physicians of any other country.

The first signs of trouble for this medical nirvana came in the form of price discounts negotiated by or on behalf of large corporations. Then came “managed care,” an attempt by businesses to scrutinize the decisions of physicians and other health care providers in order to weed out services that might not be medically necessary. To make matters especially galling, the scrutiny often came from nonphysicians who refused payment for diagnostic or therapeutic procedures not listed on “protocols” for appropriate care of patients with particular symptoms.

Such negotiated discounts and supervision did not prevent physicians’ salaries from reaching all-time highs in the early 1990s. But the introduction of new physician payment scales in 1992 under medicare reversed this trend. Justified initially as a tool to increase the pay of primary care physicians relative to specialists, these scales were soon used to hold down overall physician fees, as they had been earlier in Canada. When physicians boosted volume to maintain their incomes, fees were cut proportionately. Private insurers, observing the savings under medicare, soon emulated its payment methods. With their clinical freedom circumscribed and their incomes falling, doctors suddenly discovered opportunity as well as peril in the prospect of major change in the system of paying for health care.

Hospital administrators were nearly as blessed as doctors in the 1970s and 1980s. They faced some regulatory restraints, but the government enforced them half-heartedly and ineffectually. Suppliers of medical equipment, devices, supplies, and pharmaceuticals confronted deep-pocketed customers who couldn’t get enough of whatever was new and better, whether

quality improvements were large or small relative to cost.

As government and private insurers became increasingly cost conscious, a peculiarity of hospital economics came to haunt administrators. When hospitals are not full, the cost of serving one more patient is less than the average cost of hospital care. Since most hospitals in the early 1990s found themselves with large numbers of empty beds they needed to fill, they accepted reimbursement from insurers at rates that more than covered the incremental cost of serving added patients but did not cover the average cost of hospital care. At the same time, the federal government systematically failed to boost medicare payments as fast as the cost of care increased. The predictable result was the emergence of hospital operating losses in the mid-1990s.

Other developments undermined satisfaction with health insurance. Federal legislation enacted in 1974 led most large companies to self-insure and use insurance companies simply to process bills. Small businesses found insurance increasingly costly or simply unavailable, as insurance companies became adept at pinpointing businesses, occupations, and individuals likely to generate large health costs. Insurers used this information to boost rates or deny coverage for high-risk customers. They also excluded preexisting conditions from coverage and required employers to exclude high-risk individuals from company plans. As a result, most employees in companies with fewer than ten workers were uninsured.

Rising Costs and the Collapse of the System

The forces that had weakened support for the health care financing system during the 1980s intensified during the 1990s and led to its collapse. Despite vigorous private and public efforts to control health care spending, growth in the share of national income devoted to health care accelerated. Health care spending exceeded

Rising costs predictably led to a decrease in the reach of health insurance. In their efforts to cut costs, some employers simply dropped insurance plans. Some workers paid the high premiums for individual insurance, but others “went bare.”

12 percent of gross national product in 1990 and 13 percent in 1991.

A host of new diagnostic and therapeutic procedures, some developed in the 1980s, flooded the market. Ear implants assisted the hearing impaired. Artificial skin saved the lives of burn victims. A spate of new machines, even more expensive than the CT scanners and magnetic resonance imaging they supplemented, came into widespread use. An implantable left-ventricle assist device spared thousands of victims of heart disease from premature death. Fruits of research in molecular biology and genetics began to pour out of private and public laboratories. Almost all these advances shared two highly disturbing characteristics for those responsible for paying for health care—enormous potential benefits for hundreds of thousands of patients each year and terrifying costs per patient.

In response to these developments, employers realized they could no longer control costs. Managed care achieved modest savings. Government-supported research on the effectiveness of commonly used technologies found some therapies that were overused. Hospitals improved their management; some even adopted Japanese “just-in-time” inventory methods for supplies. But these savings could be achieved only once. They were overshadowed by new wonders spilling from the technological cornucopia. Although fee limits began to depress physician incomes, salaries of other health care professionals continued to rise faster than average wages. Administrative costs of both hospitals and physicians continued to rise as varieties of managed care and insurance plans proliferated. While each innovation in payment seemed to achieve some saving, the net effect was that increasing numbers of clerks were hired to process claims and collect from both employers and patients.

Rising costs predictably led to a decrease in the reach of health insurance. In their efforts to cut costs, some employers simply dropped insurance plans. Some workers paid the high premiums for individual insurance, but others “went bare.” Even those employers who continued to sponsor insurance shifted more and more costs to employees. Increasingly, employees decided to forgo insurance for themselves and their dependents. The number of uninsured Americans rose from 33 million at the close of the 1980s to more than 40 million in 1996.

The Presidential Elections of 1992 and 1996

These developments transformed the politics of health care financing during President Bush’s second term. His popularity buoyed by the stunning military success of the war against Iraq in 1991, President Bush had seen little purpose in injecting issues as technically complex and controversial as health care financing reform into his 1992 reelection strategy. Election results confirmed the wisdom of the strategy. By 1996, however, the numerous candidates for the presidential nomination in both parties discovered during their travels that health care financing had become the top domestic political issue. The various groups that in earlier years had desultorily tabled diverse reforms to improve a system that already treated each of them

quite well came to realize that they were operating under a system they could no longer tolerate. Business had become disenchanted with the capacity of managed care to slow the growth of spending and recognized that it needed government help. The general public had become angry and frightened as out-of-pocket costs increased and the threat of losing coverage altogether became real, not just for the poor but also for the middle class. Polls reported that the cost of health care and the fear of losing insurance coverage topped lists of domestic concerns.

Exquisitely attuned as always to the popular mood, candidate after candidate began to use calls for reform of health care financing as applause lines in stock speeches. One-line comments expanded to major themes, which became important planks in the party platforms. Republicans emphasized the need to control costs, Democrats the importance of assuring access. But the statements of each party reflected a new understanding that significant progress in dealing with either problem required solution of both. The reason was quite simple. Extending insurance and assuring adequate coverage would push up already onerous costs. Controlling costs would lead to measures that curtailed insurance and thereby added to the ranks of the uninsured. The isolated effort to solve one problem made the other problem worse. Partial solutions were dubious policy and ruinous politics. As election day approached, the two candidates were in essential agreement on the need for basic reform of health care financing. Whatever else happened after the election, the health care financing system of the United States appeared certain to change.

Immediately after the inauguration the newly elected president announced that reform of health care financing was the top domestic priority and created a cabinet-level task force instructed to submit a reform plan by Labor Day. Most of the work of the task force took place in small committees and working groups too numerous and narrowly focused to permit press coverage. But the working papers and diaries of the debates released last year clearly show how the administration proposal evolved.

The Four Competing Proposals

The task force had to choose among four broad classes of reforms. The first consisted of numerous incremental reforms that had been on the table for several years, including extending medicaid, the government program of insurance for welfare recipients, and prohibiting practices by private insurers that narrow coverage. The task force rapidly concluded that such reforms were too little and too late. They offered no way to curtail excessively costly, low-benefit medical expenditures. While they might marginally increase insurance coverage, the gains would be small and slow in coming. Time had run out on incrementalism.

Of three more comprehensive strategies with the potential to assure access and control costs, two were just too upsetting to deeply entrenched contractual arrangements and entailed an almost revolutionary redistribution of costs. Some Republicans, including those who paid most attention to health care issues, had long

avored refundable tax credits to individuals to offset the cost of health insurance premiums, combined with a requirement that employers sponsor (but not pay for) health insurance. This approach promised every American the means to have basic health insurance but kept the free market for insurance intact. It embodied the traditional conservative desire to leave resource allocation to markets and free choice. But it suffered from two fatal shortcomings. First, it offered no way to control costs, and no one any longer believed seriously that managed care could do the job. Second, the tax increases necessary to replace the revenue loss from the tax credits were large—equivalent to a 25 percent increase in personal income taxes. And the added taxes would go largely to relieve businesses of the premium costs they had paid for years. Allowing reform of health care financing to provide business with a huge windfall was unacceptable. An alternative would be to increase the corporation income tax to offset the windfall. But that tax would have to be *doubled*, and the result would be large net losses for some companies and large net gains for others.

No to National Health Insurance

If the Republicans' plan fared poorly in task force deliberations, the favorite plan of many Democrats did even worse. For decades liberal Democrats had favored national health insurance that would entitle all Americans to a specified list of health services for which they would pay little or nothing at the time of care. The federal government would pay for these benefits out of increased taxes. This plan credibly promised universal coverage, and most versions of it charged some governmental agency with managing total health care spending.

When the task force considered this approach, some members continued to voice a deep suspicion of the dangers of bureaucratization and rigidity. Proponents of national health insurance countered that bureaucratic rigidity could hardly be more expensive than the administrative overhead associated with the current system or with any system that inflicted dozens of separate payment systems on hospitals, physicians, and individuals.

In the end, the committee did not seriously entertain national health insurance for the same reason that it rejected reforms based on tax credits. National health insurance produced windfall gains and losses that dwarfed those arising under tax credit-based reforms. Nearly all the costs of acute health care borne by private payers would be brought into the federal budget. Quite apart from the staggering increase in the apparent size of the public sector, this reform would require added taxes equivalent to a personal tax increase of more than 50 percent. Once again, some would reap huge gains, others would suffer equally large losses.

The one remaining strategy was mandatory employer-sponsored and financed insurance, combined with a public plan to cover those not connected to someone in the workforce. It had an inglorious political history, having been enacted in Massachusetts under Governor Dukakis, but largely scuttled by his suc-

cessor, Governor Weld. A senior congressional aide explained national inattention to this approach during the early 1990s by remarking that "President Bush did not regard his election as a mandate to implement Michael Dukakis's health policy."

Mandatory employer-sponsored health insurance suffered from a number of substantive shortcomings, but most had partial if not complete solutions. By increasing costs to employers, this approach threatened jobs of some low-wage workers. Under a "play-or-pay" variant, however, employers were given the option of paying a tax instead of financing health insurance. Vexing administrative problems concerning coverage for dependents and maintenance of insurance when people change jobs or leave or enter the labor force also had solutions, some of which were inelegant and cumbersome. The most crucial shortcoming of employment-based insurance was that it lacked a mechanism for controlling costs. To meet this objection, the 1998 act set up regional entities under state governments to enforce budget limits. All payments for health care would be funneled through these regional agencies, which would be empowered to negotiate with hospitals and physicians on how total health care spending would be distributed among various providers. Operating under fixed budgets set by Congress, these agencies, consisting of community representatives, health care providers, and ethicists, would establish budgets for hospitals and lists of services that would be paid for only if provided under these budgets. They would also set fee schedules for physicians and establish special payment rules for health maintenance organizations, which offer their customers both hospital and ambulatory care.

The Worst Alternative Except for All the Others

In the end, the decisive advantage of employer-sponsored insurance was what some regarded as its weakness—it disturbed existing financial and contractual relations less than all of the alternatives. Mandatory employer-sponsored insurance did not require the abrupt replacement of all existing arrangements for the purchase of health insurance. It did not force tens of thousands of employees at insurance companies and in benefits offices of U.S. corporations to find new jobs. The budget costs of the subsidies to companies unduly burdened by the insurance requirement and of the back-up public plan, which supplanted the existing medicaid program, were only about one-fourth those of the tax-credit approach and one-tenth those of national health insurance. One task force member remarked that mandatory employer-sponsored insurance reminded him of Churchill's characterization of democracy: "the worst system of government, except for all the others."

The task force submitted its report as instructed at the start of July 1997. The Congressional Budget Office certified the cost of the recommended plan. Congress returned from its recess to start debate. Despite demonstrable seriousness of purpose, hearings were not completed until mid-October in the House and spilled over to the next year in the Senate. The groups affected by health care financing are numerous

While every other developed country long ago curbed health care spending and thereby denied their insured populations some of the fruits of new technology, the United States has never done so.

and contribute generously to congressional campaigns. All insisted on testifying. The tone of the hearings differed markedly from those of preceding years. Members who in the past had taken the stance of "my reform or none" seemed to recognize that action was imperative and compromise unavoidable. The administration's bill passed the House with modest amendments in late November. The Senate did not vote before adjournment, but took up the bill immediately in January 1998 and passed it in March. The conference committee ironed out differences, and both houses passed the conference bill. The president signed the bill, appropriately in view of the new taxes it imposed, on April 15, 1998.

The Future

The implementation of the reforms in health care financing has proceeded smoothly so far. Employers who had never sponsored plans have introduced them. Transitional assistance has relieved small employers and those with low average wages of much of the added cost of these plans. Some employers have elected to pay increased taxes rather than sponsor insurance plans, relegating their employees and dependents to the public plan. Owners of a few small companies have claimed that the new plan drove them out of business. Perhaps the most visible economic effect has been a small but detectable rise in the price of fast food, whose purveyors almost never before offered their employees health insurance.

Two important issues confront the nation and health care planners. The first concerns the long-term role for private health insurance and public coverage. The administration's task force and Congress agreed that while private insurance should not be abruptly replaced with a public plan, the responsibilities of private insurance should be limited. Accordingly, the 1998 law contains a provision that helps private insurance work better in the short run but that permits evolution

of the system away from private insurance. The public plan covers not only those who are uninsured through employment but also annual health care expenditures exceeding \$30,000 for any individual. This provision spares private insurance responsibility for the small minority of cases that account for a disproportionate share of total outlays. It thereby permits insurance companies to set premiums without fear of back-breaking losses that made small group and individual coverage prohibitively costly. If that threshold is adjusted for inflation, private insurance will retain its current place. If the threshold is held constant, however, it will gradually transfer financial responsibility for health care from private insurance to the public plan. Because this debate lies in the future, supporters of private insurance could join supporters of public health insurance in passing the 1998 bill, leaving to a later day the debate about the eventual shape of health care financing.

The second crucial issue concerns the way in which the powers to control growth of health care spending created in 1998 will be used. If growth of total spending is to be slowed, total budgets must be limited, which means in turn that not every beneficial diagnostic or therapeutic procedure will be available for all patients. Some sick patients will be denied care that could cure or comfort. The United States will have to fashion and accept methods of rationing care that are fair and medically rational. This job is analytically complex and touches the most basic fears and aspirations of every person. While every other developed country long ago curbed health care spending and thereby denied their insured populations some of the fruits of new technology, the United States has never done so. The job of reforming health care financing to provide everyone with access is child's play compared with the problem of how to use the new cost-control tools to slow the growth of health care spending. This is the health care financing problem of the new century. ■

They Never Tear the Cuff Links

Although some professional budget watchers, especially in the press, have begun to describe current fiscal policies as though they were rational, most Americans find little that makes sense in an unending string of \$200 billion deficits.

Trying to make sense of those deficits can be a dismal process. Those determined to sort it all out will get no help from the budgeteers at work in either the executive or legislative branch. These masters of smoke and mirrors have spent too many hours mastering the budget argot. Theirs is the insider's doublespeak of figures and tables designed to present the viewpoint of the designer rather than shed light on the process or the problem. They, more than most, know that if figures are tortured enough, they will confess to anything.

Dealing with the budgeteers on their own terms is impossible. Opt instead for simplicity. A peek into the till quickly shows where we are. And everyone knows where we want to be. Why can't we get there from here?

Congress, as it often brags, has been constitutionally empowered to control the public purse. In this time of divided government, and especially since the Budget and Anti-Impoundment Act of 1974, Congress has flexed its already strong muscles and further circumscribed the limited influence of the executive in the budget and appropriations process that annually sets U.S. fiscal policy. The president has the first shot when he presents the budget, and the last, should he cast a veto. He is an important player, but he is clearly not the dominant budget player that Congress is. Therefore a look at the congressional incentive system is in order.

Congress is supposed to be motivated by a noble desire to produce the fiscal policy

that best serves the republic. In fact, it is. However, close observers of its work have been unable to avoid the conclusion that it also seems driven to vote for an astounding array of often duplicative benefits that are pursued annually by a wide range of interests. The interests then, in turn, gratefully contribute their votes and support to their congressional benefactors. The reward is reelection. The system is not foolproof, but the 90-plus percent reelection rate for Congress over the past two decades is at least some evidence of unusual reliability.

This incentive system is exacerbated by current voting patterns in the United States. Fewer than four in ten eligible voters vote in nonpresidential federal elections. Low turnouts put a higher premium on the support of highly organized interests whose members or supporters have potentially high voting rates. Assuming that the goals of all groups are relatively worthy, it is not hard to see why Congress has a hard time resisting the claims pressed by the groups. Nor is it hard to see why Congress finds it hard to choose between them. It is easier, and more rewarding, to yield to all, or to a large number of them.

Doing Well by Doing Good

It should be noted here that the process is not corrupt, nor is it vote-selling. Congress is funding causes it favors and is then rewarded in return. Congress perceives itself as doing well by doing good. The trouble with the system is that it can't be turned off. When doing good turns a bit sour, as in the current deficit difficulties, there is no way to stop it.

The system has helped to create a spending machine in which programs grow inexorably, often vigorously. All are automatically indexed for inflation and demographic growth, and most grow even

faster. Existing programs have first claim on resources. Congress's bottom line on spending is that almost every interest that is now in the budget will remain forever on an ascending basis.

This reverence for old programs has caused all deficit-relief pressures to fall on new programs. Restraint mechanisms like Gramm-Rudman or the Summit Agreement of last year, though relatively weak, do curtail spending on the margin. That means funding existing programs and denying new ones. Only a few especially politically desirable new programs slip through the strictures while existing programs are almost automatically given substantial increases.

The incentive system has also been shaped by the coalition approach, both inside Congress and among the interest groups. In the old days the coalition approach was called log-rolling. The lesson is learned early and well that if one program falls, all programs are in danger. A coalition member must defend every other member's spending lest his be denied. This aspect of the incentive system prevents Congress from removing weak or less desirable spending items by amendment. Thus, while it is possible to set new priorities in a few new programs, it is not possible to weed out the least attractive of existing programs.

Across-the-board spending cuts, which are instantly perceived as a threat to all, are even more easily resisted. Although the across-the-board cut has been the spending reducers' weapon of choice in recent years, these amendments too are defeated with monotonous regularity.

The other half of the budget equation is taxes. For those who believe that all expenditures are necessary, and that increases or new programs are essential, new taxes are the correct means to attack the deficit.

Off Congressmen Who Say No

That is a legitimate approach, but the public takes a quite different attitude on taxes. The “Mondale disease” lives. Congress takes real risks if it raises taxes. The interest groups that favor spending increases sometimes propose a tax to finance their programs. In nearly every case the negative incentives associated with higher taxes overwhelm even the strongest of the interest groups. The spending proposal may endure, but the tax proposal is cast aside.

Sensible? Yes. Popular? No.

The power of public feelings on taxes was evidenced last fall when Congress went to great lengths to involve the president as political cover to help bear the burden of public disapproval of new taxes. Most comprehensive schemes to reduce deficits embrace some combination of tax increases and spending decreases, but like last year’s Summit Agreement, they are handled with extreme caution and have a tendency to backfire. The tax trade-off for spending cuts, which has been the basis of budget summitry and seems so sensible to editorialists, has not been very successful, largely because both sides of the deal are unpopular.

Perhaps the simplest way to explain why the budget deficit is out of control is to use the parable of the cuff links. In political mythology there are said to be charismatic figures whose charms are so irresistible that their adoring followers regularly attempt to strip them of their cuff links. Serious aspirants to those heights of political popularity must be yea-sayers. Politicians who say yes draw the crowds and the cheers.

At the opposite end of the popularity scale, at the seventh level of the political abyss, are the politicians who only say no. Perceived as hard-hearted, thick-crust, and mean-spirited, they inspire little politi-

cal following. These curmudgeons need never give a thought to their cuff links.

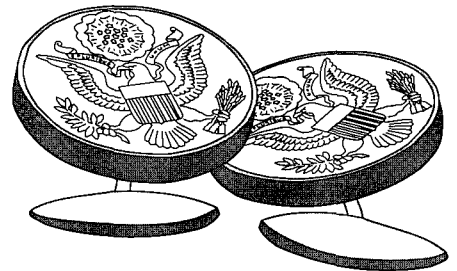
It is almost inevitable that the good news caucus will continue to outnumber the curmudgeons until the good news isn’t good any more, and until curmudgeonry takes on a good name. It is possible that deficits will be one day perceived as a crisis rather than a manageable problem. It is also possible that deficits will one day actually be a crisis. However, for the average American, deficits have not caused the sky to fall, and he or she believes that it probably won’t fall next year either. That American seems content to defend current subsidies and spending, to defend against new taxes, and thereby to defend the high and rising deficit.

No need to wonder any more why we have the deficit. It is there because Americans don’t want to get rid of it. Time and again, the public has been polled. Time and again, the answers come thundering back: deficits are bad; balance the budget; but don’t cut any of my programs and don’t raise my taxes. Time and again, Congress, a relatively representative body, struggles with those instructions. Ultimately, politically covered by the express or implied consent of the executive, it does its thing and the deficit expands. Thereafter, appreciation dinners are held, engraved plaques are hung on office walls, and more than 90 percent of Congressmen seeking reelection are returned with handsome majorities.

It is, of course, perfectly proper to blame Congress for the deficit. Congress is following the comfortable path of least resistance in spite of persuasive economic evidence that a very different fiscal policy is needed now. However, as Pogo found out long ago, the real enemy is us. Not only do we tolerate the deficit, we actually mandate it. Until attitudes change, the day of fiscal jubilation, balanced budget day, must wait. ■

Why Endless Deficits Persist

BILL FRENZEL



Bill Frenzel, a Brookings guest scholar, retired from the U.S. House of Representatives in 1990 after serving 20 years. During 1989–90 he was the ranking Republican on the House Budget Committee. He also served on the Ways and Means Committee, where he specialized in tax and trade issues. He has never lost a cuff link.

Today, the capital flood has become a capital drought. Investment has dried up, and the real estate development and finance industries are in a depression. Time for the Comptroller of the Currency to relent? Would that it were so simple. The current "credit crunch" depressing real estate markets is part of a fundamental long-run shift in real estate financial

Commercial banks also provided abundant real estate capital. They too were flooded with money when they were deregulated, along with thrifts, in 1983, just when several traditional sets of loan customers were backing out of the market. Foreign gov-

THE 1990S SHIFT IN



ernments who had borrowed heavily during the 1970s were defaulting massively on earlier loans. U.S. agriculture was depressed and unable to absorb much credit. Top-quality business firms bypassed banks and raised money directly by floating commercial paper. The collapse of oil prices removed another set of customers. Real estate—along with consumer credit and “junk bonds” used to finance mergers and acquisitions—was among the few ways left for banks to deploy their funds. So banks poured billions into construction loans on new commercial and industrial properties. The competition for loans and fees became so intense that many bankers forgot about maintaining prudent underwriting standards.

The third source of real estate capital was the boom in real estate syndication. Real estate syndicates themselves were nothing new, but the Tax Act of 1981 made them a big business. That tax law permitted wealthy investors to offset their wage and salary incomes against accounting losses generated by the theoretical depreciation of real estate improvements. Investors started regarding real estate development deals

simply as a way to shelter taxable income. Syndicators began to see them as a way to generate huge front-end fees. Neither cared much that the social function of such deals was to create space for someone to occupy. So they both pumped billions into building new properties, heedless of whether anyone needed the space.

A more prudent contributor to the capital flood was the U.S. pension fund industry, whose assets expanded by \$1.8 trillion from 1980 to 1989, reaching \$2.7 trillion in 1989—an increase of \$205 billion a year. To diversify their portfolios out of stocks and bonds, and to protect those portfolios from the inflation that had devastated them in the 1970s, pension fund executives directed extensive funds into real estate. When stock and bond values skyrocketed in the early 1980s, pension fund executives had to put even more funds into real estate to meet their percentage-of-total-assets allocation targets.

The final large source of real estate capital was foreign investors. Many financial institutions abroad were also being deregulated and were thus able, for the first time, to invest in foreign real estate. They too were

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TO DROUGHT

REAL ESTATE FINANCE

ILLUSTRATION BY
LEW AZZINARO



rapidly growing in total assets and wanted to diversify not only out of stocks and bonds, but also internationally. Because real estate yields in the United States were much higher than those in either Europe or Japan, both individuals and institutions there sent large volumes of capital to the United States to buy real estate.

The Time Was Right for Building

Events outside the financial industry also encouraged investment in U.S. commercial and industrial real estate during the 1980s. Office-based employment grew rapidly as the U.S. economy shifted emphasis from manufacturing jobs to service jobs. More and more women took jobs outside their homes—mainly in occupations located in offices or retail facilities. Also, office space per worker increased greatly to accommodate computers and other electronic equipment, as well as higher living standards among business firms. And when the 1980s began, office vacancy rates were low around the United States, averaging under 5 percent. For all these reasons, the rising prosperity during the long economic expansion after 1982 generated a strong demand for additional office and other commercial space.

The boom-and-bust cycle in world oil prices during the 1980s also affected real estate markets. When oil prices soared in the early 1980s, the economies of oil-producing states, especially Texas, experienced a superboom that sparked immense development of new commercial space, as well as a lot of land speculation. Then oil prices abruptly fell in half, plunging the economies of the Oil Patch into a virtual depression overnight. In the Houston area alone, employment fell more than 200,000 in a single year. Office and housing vacancy rates soared.

Another development affecting real estate was differences in population growth in specific regions. Suburban portions of all metropolitan areas grew rapidly compared with central cities. Southern California experienced incredible growth: six counties there, combined, grew more in the 1980s than all the 21 states in the Northeastern and Midwestern United States put together. Florida's population also increased sharply. In fact, the three states of California, Florida, and Texas captured 54 percent of the nation's overall growth during the 1980s, though they are home to less than a quarter of the nation's total population. The concentration of growth in relatively few areas attracted numerous developers to build new properties there to meet growing space needs.

The Real Estate Market in the 80s

The easy availability to developers of immense amounts of money naturally had far-reaching effects on the real estate market.

One effect was on the attitude of developers toward the property they owned. Developers have never liked to put their own cash into their projects. They prefer to use OPM—Other People's Money. Usually, however, they must put up some money of their own. During the 1980s, with so many different investors eager to put funds into real estate, developers were able to "finance out." They could either borrow 100 per-

cent or more of project costs or take in investors as equity partners to cover all costs. And many sold 100 percent interest in finished projects to financial institutions. But financial institutions do not have a traditional proprietary attitude toward ownership. Like developers, the executives in financial institutions always use OPM. That means they have no personal stake in the operation of the properties they purchase.

All those investors trying to acquire the best properties caused a steep escalation in the prices of top-quality "trophy" properties. Developers thus built new projects, not to retain them, as had been traditional, but to sell them quickly at huge profits over cost. As the "build to sell" mentality spread, developers became less concerned about the ability of their properties to remain prosperous over the long run.

The result was massive overbuilding. In 10 of the 12 years from 1978 through 1989, more than 900 million square feet of new commercial and industrial space were placed under construction each year. (Before 1978, only a single year had seen that much new construction.) The office vacancy rate reported across most key metropolitan areas by Coldwell Banker soared from less than 5 percent in 1981 to more than 20 percent by 1985—and remained above 19.5 percent for the next five years. Hotel occupancy rates declined as major chains rushed more and more new units into business. Yet in spite of these clear signs of overbuilding, both equity investors and lenders continued to pour money into financing more new projects.

After about 1985, effective rents—contract rents discounted to take concessions into account—actually fell sharply. As a result, ownership of real estate was no longer an effective hedge against inflation—a key motive for investors putting money into real property in the first place. Even when fully rented, some office buildings had such low rents that their cash flows could not cover their debt service. The result was a severe squeeze on developers. In addition, yields on real estate investment received by institutional investors plummeted far below their initial expectations, souring many on making more such investments in the 1990s.

Lenders Had Money So They Had to Spend It

Why did financial institutions continue to invest in new projects long after it was clear that property markets were overloaded with excess space? The most important reason was competitive pressure to invest the money these institutions had raised. Lenders and investors are in the business of placing funds. When they have money, they feel compelled to get rid of it. In the mid-1980s the head of a major syndication firm said to me, "We could prudently invest about \$400 million in real estate next year. But we actually have \$1 billion we must invest." In other words, he was admitting he was going to invest \$600 million imprudently. Why? To gain the fees from creating new projects. Similarly, banks, savings and loans, and pension funds—both domestic and foreign—were themselves flooded with money. They had to do something with it, preferably something that would produce large "front end" fees for their institutions.

Because all this money was OPM, bankers did not

have a cautious, proprietary attitude toward spending it. Underwriting standards among even the supposedly more sophisticated banks and other financial institutions became amazingly lax. The dangers of the lax standards were partly concealed by the time it takes to complete big real estate development projects. Once a funding commitment is made, five years or more can elapse before the building opens its doors—and the owners discover whether or not there is a real market for the space.

Meanwhile, the development and real estate finance industry was expanding tremendously. The superboom attracted thousands of new firms and more thousands of people. The ultimate sign of the industry's overexpansion was the rather sudden appearance of real estate departments and courses in many of the nation's top universities. These new programs have reached their maximum capacity to produce trained professionals just as the industry is plunging into a depression.

By the end of the 1980s, real estate development and ownership were being dominated by large financial institutions—both domestic and foreign pension funds, insurance companies, big banks, and firms that manage money for pension funds. These big institutions not only put up the money to build most large-scale properties, but also to retain ownership of them.

Then You Saw It, Now You Don't

During the late 1980s real estate capital began to dry up. First, the savings and loan industry collapsed. By 1988 thrifts had in practice stopped almost all commercial real estate loans, and the 1989 Financial Institutions Reform and Recovery Act made it virtually impossible even for healthy thrifts to invest in nonresidential mortgages or development.

The Comptroller of the Currency's decision in February of 1990 to have bank regulators crack down on real estate loans was reinforced by Wall Street's hammering down the stock prices of banks with large shares of real estate loans among their assets. Bankers were traumatized into rejecting even clearly high-quality real estate loans. As a result, the market prices of even high-quality real estate are below levels justified by their true long-term earning power.

While all this was happening, foreign investors were shifting their attention away from U.S. real estate markets. Expanded investment opportunities beckoned in newly liberated Eastern Europe, in a Western Europe buoyed by the promise of relaxed trade barriers in 1992, and in emergent industrializing nations in Asia. Japanese investors were hampered by a tremendous fall in the Japanese stock market that reduced investor liquidity, especially among big Japanese banks that had been making risky construction loans in the United States. And the rise in value of the yen against the dollar after 1985 caused Japan's trade surplus with the United States to fall somewhat.

Meanwhile, the rate of growth in the total assets of major U.S. private pension funds was slowing sharply. Many big firms had already fully funded their pension funds, and an aging workforce was beginning to withdraw more money. Moreover, pension fund managers were disillusioned by the poor yield performance of

HOW THE CAPITAL FLOOD HELPED SINK THE THRIFT INDUSTRY



One consequence of the 1983 deregulation of the thrift industry was that some savings and loan executives undertook massive financial gambles, the major risks of which were borne by taxpayers because thrift deposits were insured by the federal government. The gamblers bought control of small stock-based

(not mutual) thrifts for tiny initial investments. They then rapidly expanded the assets of those thrifts by offering high interest rates to savers. With deposits federally insured, savers did not care whether the institutions in which they put their money were well run. Moreover, a savings-brokerage industry arose to help savers find the highest yields available. So savers poured billions of dollars into these high-interest-paying thrifts. But to pay such high deposit rates, these thrifts had to invest their funds in ventures that promised to pay high yields—naturally, the riskiest ventures around. In theory, earning even a tiny profit rate on such a huge asset base would cause an enormous rate of profit against the owners' small initial investment. If the theory didn't work, the investors would not have to pay off their depositors, who were insured by the federal government.

Unfortunately, many of these high-risk ventures failed. The inflation that thrift executives hoped would raise property values in the 1980s the way it had in the 1970s never materialized. The economies of the U.S. Oil Patch collapsed when world oil prices plunged in the mid-1980s. And the flood of money into thrifts created an atmosphere of reckless extravagance often accompanied by flagrant fraud. The losses piled up by just a few dozen followers of this fast-growth strategy ballooned into many billions that exhausted the Federal Deposit Insurance Company's resources and accelerated the collapse of the thrift industry.

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real estate equities in the late 1980s. Hence, though pension funds remain a chief source of capital for real estate markets, they will put far less money into them in the 1990s than in the 1980s.

Shrinking sources of capital are not the real estate industry's only problem. During the decade ahead gross national product, population, household formation, and the size of the labor force are all expected to expand more slowly than they did during the 1980s. The rate at which women enter the labor force will also slow down—as will the shift of jobs from manufacturing to service activities. Hence the demand for office and other commercial space is likely to grow more slowly in the 1990s than at any other time since 1945. All these trends will give investors less incentive to put money into creating more new space.

What's in Store for the Real Estate Market?

Almost all that characterized the real estate market during the past decade will be different over the next few years. One thing, unfortunately, that will not change is real interest rates for nonresidential real estate. They will stay high. True, interest rates in general may be pushed down by the Federal Reserve to combat the 1990–91 recession. But people seeking to borrow to finance real estate transactions will still have to pay high real rates because of the greater perceived risks associated with those projects.

In fact, as of early 1991 the increasingly widespread “credit crunch” was drastically restricting the availability of money to real estate investors on *any* terms. If the crunch continues throughout 1991, the supposed market values of many sound properties will be forced lower than is really justified. Why? Because appraisers are evaluating those sound properties using comparable prices based upon distressed sales in an abnormally low-liquidity market. Appraisers are thus using liquidation values rather than true long-term earning power values in estimating current prices. Hence, compelling all financial institutions owning real estate to “mark to market” all their properties will undermine the values of their portfolios. Ironically, adopting this policy to protect financial institutions could seriously weaken many. In March 1991, top-level federal financial regulators issued a directive to banks and regulators to ease the current liquidity squeeze to avoid this outcome. But it may take many months for this change in behavior to filter down to the lower levels where loan decisions are actually made.

One result of the credit crunch is that all financial institutions have begun to tighten underwriting standards. Henceforth, borrowers will be required to furnish more genuine cash equity up front, provide better documentation of the market positions of their properties, get commitments for long-term financing before they can obtain construction loans, provide higher debt-service coverage, and make more realistic projections of future earnings than they did in the 1980s.

The capital drought will cause a dramatic decline in new development. Existing supplies in most metropolitan areas are adequate for at least three years, and often for five or more. From 1990 through at least 1992 and perhaps as long as 1994, new commercial

real estate development will fall well below recent levels. By July 1990 the annual rate at which new industrial and commercial space was being placed under construction contracts had already fallen 38 percent below its average of 998 million square feet for the period 1984–89. It will fall even farther. Even when the economy as a whole comes out of its current recession, new development of commercial space will lag behind. At no time during the 1990s will such new development activity return to the levels of the 1980s.

That means the real estate development and finance industries must shrink drastically. Whole firms engaged in development, architecture, consulting, engineering, and mortgage financing are going to disappear altogether. Already, every major development firm has laid off significant numbers of employees and shifted its focus from new construction to property management. Even big financial institutions will slash their real estate staffs. And people laid off will have a terrible time finding new jobs, since every other firm engaged in real estate is also cutting back its staff. For many, the only choice will be to shift to a new industry.

Rents and Prices on the Downslide

The real estate capital drought will also affect rents and property prices. Competition among property owners for tenants is still driving effective rents down in many markets. This reduction in incomes will soon spread to properties whose tenants signed long-term leases when rents were much higher than they are now—say, in the early 1980s. When current leases in those buildings expire, tenants will demand big reductions or move to nearby buildings offering substantial rent concessions. Eventually, a combination of much lower new construction and increases in space demand due to general economic recovery will soak up some of the vacant space now overloading most markets. After that happens, effective rents can stabilize and eventually begin rising again. But that will not happen for at least a year in any markets and not until after several years in many.

Property prices will follow a similar path. One reason is that property prices in the 1990s will be much more closely linked to operating profits derived from rents than they were in the 1980s. Then, intense competition among investors seeking to purchase properties actually drove prices of high-quality properties up at the same time that their net rental incomes were declining. That divorce of market prices from net rental incomes caused falling capitalization rates. But those rates have risen sharply in the past two years. In fact, prices of nonresidential real estate assets are now falling almost everywhere across the nation. Values have dropped 15–25 percent in most markets during the past 18 months, and much more in some cases. They will continue to fall until the balance of supply and demand in each market becomes stabilized as fewer new buildings go up and as vacancy rates go down with rising prosperity. After that, if rents start rising, so will property prices.

This likely down-and-up movement of both rents and prices over the next few years has three important implications. First, wise owners will avoid selling real estate during the next one to three years if they can.

Second, though prices will decline, there will not be any widespread “collapse” in commercial real estate prices—unless regulatory pressures inhibiting nearly all real estate lending persist through 1991 and beyond. Most owners will simply avoid putting their properties up for sale under low-liquidity conditions. Hence the number of transactions will remain very low. Third, now is a good time for investors with cash to search for existing properties that can be bought at bargain prices. But investors must exercise due diligence to avoid buying “dogs” that will never earn good profits even in much more balanced markets.

The upshot of all that has happened is a big shift of emphasis in the real estate industry from new development to the ownership and management of existing properties. These two facets of real estate have always been separate and distinct. What benefits one does not always aid the other. In fact, the superboom in new development during the late 1980s drastically undermined the profitability of existing properties by flooding markets with competitive space and driving down rents. The current slowdown in new development is exactly what owners needed to restore their prosperity. As rents start rising again, followed by property prices, owners will once more become prosperous.

Resources within the real estate industry are thus now shifting massively from new development to property and asset management. Every major firm formerly engaged in new development now declares itself to be expert in property management—and some even are! The shift is healthy for real estate and for the economy as a whole. It will result in more efficient use of the huge capital investment the world made in real estate during the superboom of the 1980s.

Good News—for Those Who Can Survive

As economist Herbert Stein once noted, “Whatever cannot go on forever must come to an end.” The superboom in new real estate development from 1978 through 1989 created additional real property at an unsustainably high rate. It had to end. What stopped it was both the drying up of the flood of capital and the inordinate supply of existing space.

Real estate markets in the 1990s will be vastly different from those of the 1980s. The next two to four years will witness a depression in new development—the worst since the 1930s. In the long run, that will be good for real estate as a whole. The slowdown in new building and the increasing use of existing space due to general economic recovery should restore a better balance between supply and demand in most nonresidential markets by the mid-1990s. In the last half of the decade, the ownership and management of real properties should be much healthier than it was in the last half of the 1980s—if no new flood of capital stimulates overbuilding again. Given rising worldwide demands for capital and a restricted supply, a continued capital drought is much more likely than any new flood. Thus, grim future prospects for new development portend happier days for the ownership and management of existing property—for those hardy enough to survive the severe liquidity squeeze now gripping the industry. ■

The Soviet Miners' Strike

BY CLIFFORD GADDY



For more than two months this spring, Soviet coal miners engaged in the most extensive labor action in the Soviet Union since the Russian Revolution. Does the settlement reached in May mark the end of labor unrest in the country? Or does the miners' strike herald a new era of political consciousness of the Soviet working class?

To answer these and other questions, it is useful to recall why the miners struck in the first place. While it is true that the miners did ultimately pose some quite political demands, their initial and basic grievances were not political but economic. At the risk of sounding cynical, I'd like to suggest that the real reason the miners struck was that there's nothing to steal in a coal mine.

Let me explain. Ever since their first walkout nearly two years ago, the miners have been demanding a pay hike of 100 percent to 150 percent. On the face of it, the demand appears curious. Soviet coal miners already have the highest wages of any major group of workers in the country, twice as high as those of the average industrial worker. Indeed, relative to other groups, they are better off now than they were ten years ago. What could then possibly impel such a privileged group to this drastic labor action, one that cost the Soviet economy billions of rubles in lost output? Equally interesting, why didn't other workers strike as well? To answer that question, we need to dispel a basic myth about the Soviet labor market.

That myth is that Soviet workers actually live on the ridiculously low wages they receive from the state. To grasp how low wages are, consider the fact that at the current *official* exchange rate for tourists in the Soviet Union, the average wage in the country is worth less than \$10 a month. It is of-

ten asked how anyone could work for such low pay. In the case of the Soviet people, the answer is simple: they can't and don't. Through absenteeism and shirking, many Soviet workers adjust their official 40-hour work week downward to 30, 25, or even 20 hours. Even more important, Soviet wages are not as small as official statistics make them out to be. The key here is to understand the difference between the official wage and the real, "hidden" wage. Through informal arrangements at the workplace, workers are provided with numerous other benefits. Some, such as company-provided housing, are well-known and official. Others, however, are highly unofficial and even illegal. Examples include payment in kind in scarce goods, outright pilferage and shirking, and opportunities for company-sponsored moonlighting on private jobs.

By the late 1970s, when this system of informal wage compensation had become truly institutionalized in the Soviet economy, unofficial sources of income amounted to as much as 50 percent or more of the official wage for some broad occupations in retail trade and services, and in many industrial sectors as well. This is the starting point for interpreting recent events, including the miners' strike.

Over the past few years, every Soviet worker's official wages have been severely eroded by inflation. Both the notorious increases in shortages and queues in the state stores and the soaring prices for comparable goods on the black market have reflected that inflation. And even though official wages have increased as well, they have lagged far behind. In this situation, most Soviet workers, rather than waiting for the increasingly paralyzed central agencies to

compensate them by raising wages, have taken matters into their own hands. Workers in the retail or consumer goods manufacturing sectors upped their rate of pilferage. Skilled workers turned to high-paying extra work in the private underground economy and, more recently, in the legal cooperative sector. Even workers in the government bureaucracy found ways to compensate—not by stealing goods, but by stealing more time. They simply started coming in later and leaving earlier from work.

But what about the coal miners? Miners had nothing to steal, either goods or time. They, unlike the other groups, *did* have to rely on central government action to raise official wages. In the end, the only means they had to enforce their demand was a strike.

Does the explanation mean that we can dismiss the threat (or the hope, depending on one's point of view) of a newly awakened political consciousness on the part of the Soviet working class? Hardly. If anything, the lesson of the miners' strike may well be the opposite: when you run out of ways to *beat* the system, you begin thinking of ways to *overthrow* it. ■

Clifford Gaddy is a research associate in the Brookings Foreign Policy Studies program. His past research has focused on informal mechanisms and the Soviet labor market.

He is currently working on a microeconomic study of Soviet defense industry conversion.

World Interest Rates

BY RALPH C. BRYANT



Should other nations change their policies to make life easier for the United States? Yes, answers the U.S. government from time to time, appearing to equate international cooperation with the desired foreign response. Not surprisingly, U.S. efforts to "cooperate" in that spirit have been less than a brilliant success.

The most recent such effort was mounted this spring, when Germany and Japan were pressed to lower their interest rates. In public statements, and probably in numerous private meetings, U.S. officials stressed an urgent need for lower world interest rates, with the implicit or sometimes explicit assertion that the Bundesbank in Germany should take the lead. Lower interest rates in Germany and other foreign nations, it was presumed, would strengthen foreign economic activity and thus U.S. exports, thereby countering the U.S. recession with expansionary stimuli from abroad.

The Bundesbank disliked the U.S. advice. Germany, enmeshed in its struggle to reunify, has recently experienced robust growth amid signs that inflationary expectations are rising. Since the hyperinflationary trauma of the 1920s, Germans have had a strong aversion to inflation. Given that predisposition and given its assessment of the country's economic situation, the German government saw the U.S. request to lower interest rates as altogether inappropriate.

The American pressure on Germany might have sprung from a naive yearning to get someone else to change policies to help ease the U.S. recession. Less simplistically, but still naively, the U.S. administration may have been arguing that Germany puts too much stress on the goal of low inflation and too little on the goals of high

employment and robust growth (translation: "Germans should have *our* priorities"). A third possibility is that U.S. officials analyzed the German economic situation differently, believing that German inflation was not threatening to increase and that growth would be insufficiently strong. Whichever attitude best describes the administrations' views, none represents a constructive approach to genuine international cooperation.

Inflation-adjusted ("real") interest rates in the world economy are still relatively high by historical standards, as they were for much of the 1980s. One explanation is that many governments have permitted budget deficits to grow excessively, thereby leaving themselves no choice but to rely unduly on tight monetary policies to curb unsustainably high growth in aggregate spending. The United States is a prime culprit, but Germany is also now in this predicament. (Recently both nations have taken some actions to reduce bloated fiscal deficits, but not enough.) The world economy would be better off with a changed "mix" of fiscal and monetary policies: more budgetary restraint and correspondingly easier monetary policies, with the combination of both policies set to maintain steady, noninflationary growth.

Over the next decade, additional demands for the world's savings are likely—for example, for investments in the East European and Soviet economies. These new circumstances make it even more plausible to argue that needed investments and vigorous growth in the world economy would be better assured if the major economies would alter their policy mixes, substituting fiscal restraint for monetary restraint, thereby lowering real interest rates below where they would otherwise be.

Did the U.S. administration have in mind such a change in the mix of fiscal and monetary policies as it pressured Germany to ease monetary policy? Probably not, to judge from the public statements. Nor would it have been credible to take such a position without proposing, first and foremost, a change in the mix of policies for the United States itself.

Increasing interdependence in the world economy does raise the potential value of intergovernmental cooperation. The essence of successful cooperation among sovereign nations, however, is a self-interested, mutual adjustment of behavior. Cooperating governments will typically not have common goals or even goals that are compatible. And to argue that other governments should give up their goals in deference to our goals is to undermine the potential for cooperation. Notwithstanding its position as the single most powerful nation in the world economy, the United States should forgo efforts to bully or lecture other governments to take actions that they perceive to be contrary to their own interests.

If the United States really wants to promote international cooperation, Americans themselves must be more forthcoming. Cooperation must begin at home. We should develop potential adjustments of U.S. policies to bring to the international bargaining table—for example, credible further progress in reducing the federal budget deficit combined with appropriate offsetting relaxation of U.S. monetary policy. Only when Americans can deliver—when we exert genuine leadership—does it make good sense to pound the table demanding actions by others. Even then, it makes more sense—and would probably be more effective—to pound it privately. ■

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How Is the President Doing?

BY BERT A. ROCKMAN



Well past the midpoint of George Bush's term, the question "How is he doing?" seems easy enough to answer. If the scarcity of Democratic contenders seeking to oust Bush in 1992 is any indication, he is doing very well indeed.

The president's persistent popularity may seem surprising to some. He lacks the obvious appeal of other presidents who fared well in popular approval. He cannot claim Eisenhower's credentials as a military hero, Kennedy's style in presenting himself, or the big ideas and bold direction that animated the Roosevelt and Reagan presidencies.

And the circumstances that propelled him into the White House were not auspicious. His electoral campaign was regarded as particularly nasty and divisive. The outcome at the polls in 1988 was ambiguous. It placed congressional Democrats in the driver's seat and in a vengeful mood, partly because of the campaign, including the "no new taxes" pledge with which Bush had sealed his nomination, and partly because Bush seemed more vulnerable than Reagan. This was hardly a recipe for presidential popularity or success.

While Bush's popularity is quantitatively demonstrable, public approval of President Bush is hardly undifferentiated. A mere few weeks after the Iraqi invasion of Kuwait, a *New York Times*-CBS poll showed Bush's overall approval at about 75 percent. But the public still had serious reservations about Bush's domestic policy performance. Even in the euphoria following the American-led coalition victory in the Persian Gulf, the discrepancy remained. Overall approval was high, but doubts about domestic policy performance persisted. What does this split-personality view of the Bush presidency tell us about how the president is perceived and how he is performing?

Public approval of presidents is

really not so mysterious. It typically has to do a lot less with who the president is and far more with what is occurring around and conditioning an incumbent's presidency.

The first year of George Bush's presidency was filled with events that transformed the world to the benefit of the United States. The Cold War ended. Europe was being reunited as the Soviet empire crumbled. Nor was the good news confined to Europe. The Sandinistas in Nicaragua were defeated by ballots rather than bullets. The sharpest criticism that could be mustered against Bush was that he was not moving fast enough to make favorable events even more favorable.

The crisis in the Persian Gulf and the military success that ensued bolstered further Bush's standing as a foreign policy leader. His reaction to events was decisive and bold even if his anticipation of them was weak.

In mid-August 1990, however, Bush's popularity briefly tumbled below 50 percent. The dip occurred while he was trying to put together a budget deal with congressional leaders. The budget package is actually one of the great achievements of the Bush presidency. But to get the deal, which was unpopular with the rank and file members of both parties in Congress, Bush had to engage in the seemingly petty politics of haggling, partisanship, and interests. It was not a pretty sight, especially while American troops were being sent to the Gulf, their lives and families suddenly disrupted.

The Gulf crisis illustrated what presidents look best at doing: successfully commanding the armed forces in a crisis and engaging in high-level diplomacy. The budget negotiations are what presidents look worst at: engaging in give-and-take politics replete with high short-term costs and no short-term benefits.

There was no way Bush could

look good in the budget negotiations. Faced with divided government and a heavily constrained budget, the Bush administration was not about to commit money to projects mostly favored by Democrats. But it did not favor the confrontational style of the Reagan administration. Instead of standing up to Congress (and accomplishing nothing), Bush zigged and zagged and was depicted in political cartoons as an unprincipled weathervane. In the process he won a budget deal that may have been unappetizing but that could at least be swallowed.

The circumstances of divided government and budget constraint virtually guarantee that Bush will govern "ugly." There will be no fanfares on the domestic front. And if the recession persists, the salience of domestic concerns will rise and Bush's fortunes probably will fall.

How well is Bush doing? Better than expected. How will he continue to do? It depends on what happens around him and what becomes salient to the American public. How well is he governing? About as well as, and probably better than, can be expected in view of the political conditions he inherited and continues to live with. Indeed, it may well be that a president of George Bush's style and limited agenda is especially suited to the divided government Americans seem bent on having. ■

Bert A. Rockman is a senior fellow in the Brookings Governmental Studies program and professor of political science and research professor in the University of Pittsburgh Center for International Studies. He recently has coedited (with Colin Campbell, S. J.) and contributed to The Bush Presidency: First Appraisals (Chatham House).

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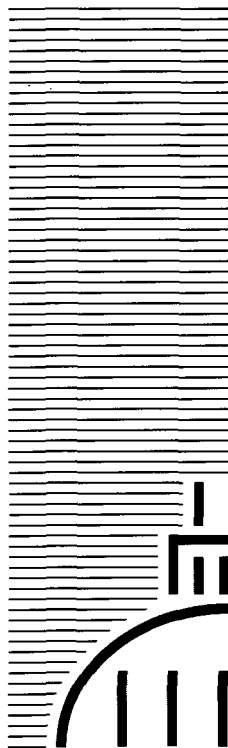
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